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THE CANADIAN BUSINESS
REVIEW

Published by The Conference Board of Canada

Volume 8 Number 2 Summer 1981

Advocacy Advertising Conference

Why are corporations and governments increasingly turning to advocacy or controversy advertising to convey their message to society at large? Why do they believe that conventional advertising and conventional media coverage fail to satisfactorily reflect their stand on many of the contentious issues confronting society today? Are there dangers in the use of advocacy advertising? Should large corporations and governments be able to take their case to the people when many of their critics are unable to buy equal space in the media? Can advocacy advertising be regulated?

These and other questions will be addressed at the Conference Board's annual public affairs conference in Toronto on November 25, 1981. Entitled "Advocacy Advertising: A Democratic Right or Propaganda?" the conference will serve to focus attention on the theory and effectiveness of advocacy advertising as well as on the current debate surrounding its place in a democratic society. The Conference Board has invited businessmen, academics, government officials and representatives of special-interest groups to present their views on advocacy advertising. Whatever its ultimate consequences, advocacy advertising is clearly a wave of the future — something that will increasingly fill our airwaves and newspapers in the 1980s.

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The Conference Board of Canada has developed a series of unique live-in courses, or workshops, for management personnel in a variety of functions. The upcoming Sales Forecasting Workshop (September 22–25, 1981, at the Guild Inn, Scarborough, Ontario) concentrates on the use of sales forecasts in decision making and is tailored to the needs of managers who work in related fields or who want a refresher course on the latest techniques.

For further information, CALL the Director of Conferences at (613) 746–1261, ext. 210.

THE CANADIAN BUSINESS REVIEW

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Inside this issue

The special report on the Ottawa Summit starting on page 6 looks *across* and *at* the issues facing the seven heads of state as they approach the Ottawa Summit in July for their seventh such meeting. A concentration of five articles is prefaced by a letter from the Prime Minister of Canada, the Right Honourable **Pierre Elliot Trudeau**.

Leading off is a comprehensive article by **A.E. Gotlieb**, Under-Secretary for External Affairs and Personal Representative of the Prime Minister in preparation for the Ottawa Summit. He takes the reader across the previous summits, starting with Rambouillet in France in 1975 and leading up to Ottawa in 1981.

A reality that must be faced by the seven heads of state is that growth in real output is strongest and unemployment least when inflation is controlled, as **Michael Parkin**, Professor of Economics at the University of Western Ontario, points out in his article on page 17. International economist **Lawrence Veit**, of Brown Brothers Harriman & Co. of New York, paints the picture of world stagflation. Slow economic growth and rising inflation are no longer strange bedfellows in the major economies of the world. But world leaders must attempt to alter that uneasy relationship if nations are to prosper. Also, pressure is mounting on policy makers to face the twin problems of petrodollar recycling and rising energy prices.

Japan is the only one of the seven to escape stagflation. Why can't we do what Japan does, asks **Jack Struthers**, Vice-President of the Canada-Japan Trade Council. He traces Japan's economic power to the roots — its unique society. In another article on Japan, **Norikazu Sato**, a visiting research associate from the Japanese Economic Research Center, singles out quality control circles as a major factor in improving product quality, keeping Japan in the lead in manufacturing.

For Canada, modest growth is expected in 1981, resting on a strong fourth-quarter performance in 1980, reports Conference Board economists **Anselm London** and **Dana Oikawa**. The outlook, on page 2, is based on the most recent quarterly survey of economic forecasters.

We haven't always had the courage to make decisions to help our economy prosper in the long term. The cost of this indecision for Canada is high, says **Robert Bandeen**, President and CEO of Canadian National (page 27).

Modern trends in female labour-force participation are put into perspective by **Beverly Cameron**, of the University of Manitoba (page 30). She cites the need to analyze the effects of women entering the paid labour force on the overall economy.

Protection of the textile and apparel industries, with the highest numbers employed in Quebec (60 per cent) and Ontario (30 per cent), has recently been debated widely. Professor **Richard Wright** of McGill University and **Ursula Kobel** of Canadian Pacific Enterprises Ltd. analyze Canada's textile import policy options (page 33). In their article they argue that permanent import controls on textiles and apparels camouflage the basic problems of a highly protected industry.

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Modest Growth Ahead

A strong fourth quarter in 1980 provides a firm base for 1981, but forecasters surveyed by the Conference Board cite many continuing problems facing the Canadian economy

by Anselm London and Dana Oikawa

The most recent quarterly survey of economic forecasters conducted by The Conference Board of Canada reveals continued bearishness concerning Canada's economic prospects for 1981. Though, on average, forecasters expect real Gross National Product to grow by 2.3 per cent this year, compared to the average of 1.2 per cent expected three months ago, this upward revision can hardly be described as evidence of a robust economic upswing. Indeed, since there was almost no growth in 1980 as a whole, the strength of the fourth quarter alone virtually assured that most forecasters would emerge with a fairly large increase in GNP for 1981.

Thus, although projections have been significantly revised, the economic conditions cited three months ago have remained largely unchanged. The Conference Board's survey reveals that the most important elements relate to economic developments in the United States, the federal-provincial energy deadlock, the cost-price outlook and, finally, monetary policy and interest rates.

In general, the forecasters surveyed by the Conference Board projected a hesitant recovery for the United States. Essentially flat throughout the first half of the year, real GNP is expected to pick up only modestly in the second half — anticipated year-over-year growth averaging a weak 1.5 per cent. A key factor in this assessment of U.S. growth prospects is the common view that interest rates will remain high. Although there was no firm consensus as to their precise quarterly movements, most forecasters saw interest rates rising once again toward the end of the year. These high interest rates are consistent with the view that double-digit inflation will persist throughout 1981.

The U.S. fiscal outlook, on the other hand, was dominated by uncertainties regarding the implementation of the Reagan administration's fiscal package. To the extent that a consensus view did emerge, most forecasters felt that the Reagan package

The authors are economists with the National Forecasting Group, The Conference Board of Canada.

Table 1
Forecasts of Economic Activity — 1981
(Percentage change except as noted)

Source	Forecast date	Real GNE	GNE deflator	CPI	Unemployment rate (%)	Corporate profits	Housing starts ('000)	90-day interest rate (%)	Exchange rate	Current account balance ($ billion)
Bank of Montreal	Apr. 6	1.9	10.5	12.5	7.6	0.0	175	16.5	84.0	−5.0
Bank of Nova Scotia	Apr. 7	1.5	11.3	12.0	7.6	5.0	175	15.0	84.8	−3.3
Burns Fry Ltd.	Apr. 8	1.0	9.0	12.0	7.5	3.5	170	16.0	84.5	−3.0
Canadian Imperial Bank of Commerce	Apr. 2	1.8	11.4	12.0	7.9	5.0	185	15.8	85.0	−4.6
Chase Econometrics Canada	Apr. 8	3.8	10.6	11.9	7.3	9.5	182	16.6	85.0	−3.0
The Conference Board of Canada	Mar. 21	2.9	10.9	11.6	7.5	9.7	177	17.1	83.6	−2.0
Data Resources Inc.	Mar. 25	3.5	10.1	12.3	7.3	13.2	173	15.0	84.7	−4.1
F. H. Deacon Hodgson Inc.	Apr. 10	1.0	10.8	12.0	7.5	6.5	163	15.0	84.5	−4.0
Dominion Securities Ltd.	Mar. 30	2.0	10.1	11.9	7.8	0.0	180	15.8	85.2	−3.5
Greenshields	Mar. 20	2.0	11.0	11.5	7.9	5.0	180	14.0	85.5	−3.5
Informetrica	Apr. 7	3.2	11.8	11.9	7.3	15.3	180	15.9	85.0	−1.4
Midland Doherty Ltd.	Mar. 9	2.0	10.2	11.7	7.9	2.0	175	16.3	83.3	−6.2
Nesbitt, Thomson & Co. Ltd.	Apr. 1	3.3	10.5	12.0	7.3	9.7	176	14.8	85.5	−3.1
Pitfield Mackay Ross Ltd.	Apr. 10	2.5	10.5	12.8	7.4	3.5	178	16.5	85.0	−2.0
Royal Bank of Canada	Mar. 12	1.8	10.5	11.7	7.6	10.0	175	14.9	84.3	−4.2
Wood Gundy	Apr. 6	2.2	10.4	11.8	7.5	2.3	182	16.2	85.0	−5.3

would meet with only limited Congressional approval, particularly with regard to its expenditure-cutting proposals. In addition, there was a general feeling that the approved measures would not come into effect until the latter half of the year. Consequently, the majority of forecasters felt that the immediate impact of the proposed fiscal measures would be smaller than that claimed by the Reagan administration.

This current-year outlook for the U.S. economy is expected to have important spillover effects on Canada over the forecast horizon. Given the less than robust recovery anticipated in the United States, Canadian exports of goods and services are forecast to remain well below the peak of $33.6 billion obtained in the fourth quarter of last year. With imports, on average, expected to grow by 2.0 per cent, the low level of exports is seen to be contributing to a deterioration in this year's current account balance. The vast majority of the forecasters surveyed expected last year's surprisingly small deficit of $1.5 billion to at least double this year, with the external value of the Canadian dollar at about $0.85 U.S.

Also reflecting developments in the United States, Canadian short-term interest rates are expected to remain high — the average forecast for the 90-day commercial paper rate standing at 15.7 per cent. This expectation stems from the widely held view that the monetary authorities in both Canada and the United States will continue to adhere firmly to their announced monetary targets. One important consequence of this development is that housing starts are expected to recover only modestly this year to approximately 177,000 units, well below the figures dictated by long-run demographic trends.

Another domestic issue on which forecasters showed general agreement is the prospect for a settlement to the federal-provincial energy deadlock. The assumption that a settlement would be reached sometime in the second half of the year was adopted by all but two of the respondents, these two feeling that a resolution was not likely. Among those forecasting an agreement, a pricing scheme higher than that proposed in the National Energy Program was expected.

Given the delay in resolving the energy-pricing stalemate, our survey suggested that Alberta oil production would be subjected to additional cutbacks. While the large majority anticipated only a second cutback, those forecasting no resolution prior to year's end assumed the adoption of yet another round of reductions. The delayed settlement is also reflected in a strong consensus that the impact of any resumption of the oil sands projects will be postponed until at least early 1982. Such a postponement would have a particularly deleterious effect on plant and equipment investment, which, on average, is forecast to grow by 3.0 per cent this year, down from the record 9 per cent average of 1979 and 1980.

With a weak U.S. economy and a confused energy-pricing environment continuing to cloud Canadian economic prospects, this year's cost-price outlook is seen by most forecasters as a source of additional strain. The view is unanimous that inflation, as measured by the Consumer Price Index, will be higher than the 10.2 per cent recorded in 1980. Accordingly, the average inflation forecast for 1981 rests at 12.0 per cent. Although most forecasters still expect inflation to outpace wages this year, there is a growing belief that this trend may be reversed by year's end.

Meanwhile, a moderate expansion in the labour force is expected to be largely absorbed by employment growth, leading most respondents to forecast little change in the unemployment rate for 1981. With output forecasts varying widely, however, no firm consensus emerged regarding changes in productivity. Opinions on this indicator were divided evenly between small gains and small losses over the year.

In summary, therefore, the survey of forecasters indicates that the prospects for a strong Canadian recovery from last year's recession are not altogether favourable. With the outlook for a sustained burst of activity in the United States clouded by political and other uncertainties, exports cannot be relied upon, as in previous years, to provide a major source of growth. Moreover, high interest rates, accelerating inflation and a weakened investment outlook are expected to further hinder expansion, making 1981 a year of lacklustre economic prospects.

Table 2
Forecasts of Economic Activity — 1981 — Summary
(Percentage change except as noted)

	Real GNE	GNE deflator	CPI	Unemployment rate (%)	Corporate profits	Housing starts ('000)	90-day interest rate (%)	Exchange rate	Current account balance ($ billion)
Low forecast	1.0	9.0	11.5	7.3	0.0	163	14.0	83.3	−1.4
Average forecast	2.3	10.6	12.0	7.6	6.3	177	15.7	84.7	−3.6
High forecast	3.8	11.8	12.8	7.9	15.3	185	17.1	85.5	−6.2

Table 3
Forecasts of Economic Activity — 1981
(Percentage change in constant $ quantities except as noted)

Source	Consumption	Plant & equipment investment	Residential construction	Government spending	Exports	Imports	Inventory investment ($ billion)	Export prices	Import prices	U.S. real GNE
Bank of Montreal	1.9	3.0	0.1	1.3	1.2	1.0	0.0	6.0	9.0	1.3
Bank of Nova Scotia	1.0	4.5	2.3	1.0	1.5	1.5	0.4	10.0	12.0	1.5
Burns Fry Ltd.	0.2	0.8	2.0	0.6	−2.0	0.0	0.5	9.0	9.0	1.4
Canadian Imperial Bank of Commerce	1.8	2.2	5.2	0.8	1.1	2.5	−0.3	11.9	13.3	0.8
Chase Econometrics Canada	3.5	4.9	6.1	1.2	−1.8	−0.7	−0.2	10.5	10.8	1.4
The Conference Board of Canada	2.6	3.6	−1.1	0.9	3.5	3.1	0.0	9.6	9.7	2.2
Data Resources Inc.	3.5	4.9	0.8	1.3	5.5	5.6	0.4	10.3	12.0	1.6
F. H. Deacon Hodgson Inc.	1.0	0.0	−2.0	1.4	−0.4	−1.5	−0.1	8.2	10.6	NA
Dominion Securities Ltd.	1.6	3.4	6.0	0.0	1.1	2.3	0.1	10.1	10.5	1.5
Greenshields	2.0	4.5	2.5	1.5	−1.0	1.0	−0.1	10.2	10.2	1.0
Informetrica	2.0	3.3	0.8	1.3	4.1	2.2	0.0	10.4	11.9	2.3
Midland Doherty Ltd.	2.2	0.6	−0.9	1.2	3.0	4.2	0.2	9.3	11.2	1.2
Nesbitt, Thomson & Co. Ltd.	3.3	2.3	5.1	1.6	5.2	4.0	−0.3	10.0	11.7	2.1
Pitfield Mackay Ross Ltd.	2.0	3.0	2.0	1.3	0.5	1.1	0.0	12.9	12.2	2.3
Royal Bank of Canada	1.6	3.8	2.6	1.1	3.7	4.2	−0.7	11.2	12.4	1.3
Wood Gundy	2.3	3.0	1.5	0.8	0.0	0.8	−0.4	10.7	12.1	1.3

CANADA

MESSAGE FROM THE PRIME MINISTER MESSAGE DU PREMIER MINISTRE

The initiative of the Canadian Business Review in producing an edition focusing on the Ottawa Summit is a happy one. As you know, I attach great importance to these Summit meetings as a venue for consultation among the major industrialized democracies, on matters which are of vital importance to us all.

Economic issues are of paramount importance at these meetings and I am delighted that a journal of your stature, which has a wide circulation in the business community, is using this occasion to make Summits better known to its readers.

The Government is anxious to take into account the views of the private sector on Summit concerns. I believe your publication on the Summit will give a better understanding of the nature of these problems, and of the steps Governments at the highest level are considering to grapple with them.

P. E. Trudeau

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Across the Western Economic Summits

Summits have increasingly come to play a major role in the calendar of the whole international economic process

by A.E. Gotlieb

The emergence of periodic meetings of the leaders of the most important economic partners among the developed, industrialized, mixed-economy nations, the so-called Western Economic Summits, has been one of the more interesting diplomatic phenomena in the latter half of the 1970s and now the early 1980s.

Meetings at the summit level have not always had good reviews — witness Yalta or the Versailles negotiations after World War I among Wilson, Lloyd George and Clemenceau. Even Moses had difficulty persuading those left behind of the wisdom he brought back from the summit! Not a few leaders have reason to ponder the old Japanese saying that "there are two kinds of fools: those who have never climbed Mount Fuji, and those who have climbed it twice."[1]

After all, what court of appeal is there from a head of government? Who will review his decisions, revise his instructions?

[1] Acknowledgements for this paragraph to Arthur Andrew, formerly a senior officer of External Affairs.

The author is Under-Secretary of State for External Affairs and Personal Representative of the Prime Minister of Canada in preparation for the Ottawa Summit.

Yet beginning in 1975, at Rambouillet near Paris, there have been annual meetings of major Western leaders: 1976 in Puerto Rico, 1977 in London, 1978 in Bonn, 1979 in Tokyo, 1980 in Venice. With the July 1981 meeting in Ottawa we will see the end of a cycle: each of the seven participating countries will have hosted one summit. The U.S. and French presidents, the German chancellor, the Japanese, British and Italian prime ministers have participated from the outset, joined by the Canadian prime minister since Puerto Rico and the president of the European Commission since London.

These seven heads of state or government represent countries that together account for around half of world trade and for about four fifths of the industrial countries' and over half of the world's output. There is a considerable gap between the political/economic stature of the smallest summit participant and that of any potential Organization for Economic Cooperation and Development (OECD) summit aspirant. As for the presence of the commission president, it must be remembered that the European Community member states have by treaty handed over to the central community institutions certain important elements of their sovereignty, notably for trade policy as well as other aspects of economic policies.

Why the summits began

We need to go back to the situation in 1975. Two years after the Yom Kippur War and the ensuing fourfold increase (by December 1973) in oil prices by the Organization of Petroleum Exporting Countries (OPEC), it was painfully evident that the industrialized countries had not coped well or cohesively with the fallout. They were confronting major and pressing economic problems (recession and unemployment, accompanied by inflation), many of which indeed originated before the oil shock, arising in part out of the persistent current account deficits of the United States. When the International Monetary Fund (IMF) Interim Committee in June 1975 failed to agree on how to approach major monetary issues (exchange rates, quotas, gold), the French president, elected to his seven-year term little more than a year earlier and himself a former finance minister, suggested a monetary summit on the ground that it was largely the floating exchange rates that were destabilizing the monetary system and thus causing the major economic problems.

. . . the coming together for a summit served as a highly public recognition of the altered and more complex circumstances of the 1970s.

After some hesitation, the other leaders accepted. They went to Rambouillet in November 1975, but only after agreement that the agenda provide for consideration of overall economic policies as well as monetary issues and look too at North/South problems. The summit was to take an overall, policy-oriented, rather than narrowly technical, approach. The emphasis was on coordination: leaders intended to underline they were in command, were working together and would get their economies moving again. By concerting their economic policies and by mutual reinforcement and burden sharing, it was thought that the key countries could assure and consolidate the recovery without additional inflation.

Although arising out of a specific situation, this development — the coming together for a summit — served as a highly public recognition of the altered and more complex circumstances of the 1970s. In the '60s or '50s — and notably the '40s, which had seen the establishment of most of the principal international economic institutions — the United States was virtually unchallengeable in its supremacy in the non-communist world and far outdistanced the USSR as well on most criteria of power. But by the early 1970s, no longer was there a solitary colossus bestriding the non-communist world. President Nixon in a variety of ways had recognized the limits to U.S. power — economic, political and military — and had altered U.S. commitments accordingly. The U.S. could no longer carry the whole burden alone and was moved to recognize other centres of strength. In particular, the Europeans and Japanese had to take on responsibilities for the functioning of the economic system and be given a commensurate voice in the decision making (an exercise in power sharing of a sort to which I shall refer later in relation to the South).

There were shifts going on as well between the West and other parts of the world. Soviet military power was relatively much greater than it had been, including notably in the field of nuclear weapons. The Sino-Soviet split worsened, and China itself was beginning to play a more active part in the world. OPEC muscle had recently been demonstrated, and the sudden transfer of wealth to oil producers, notably the few surplus countries (e.g., Saudi Arabia, Kuwait and the United Arab Emirates), can only be compared to the massive acquisition of gold by Spain in the sixteenth century. It gave rise to fears, not wholly substantiated, of a more generalized "commodity power" by raw materials producers. The oil crisis, along with other factors including commodity fears, gave impetus to recognition by Western leaders of the need to take North/South issues more seriously. Indeed, the Conference on International Economic Cooperation, involving 27 developed and developing countries, opened in Paris a week after the first summit.

The leaders of the major Western economic powers accordingly felt constrained to consult, to try to work together more closely — and to be seen to be doing so. At the same time, the leaders were careful to make clear they were not establishing a new institution. Indeed, and this was fundamental, they wanted to find a way of leap-frogging the national and international bureaucracies.

Economic summits to date

An analysis of the six economic summits as a series may give an erroneous impression of inevitable flow or progression from one to the next. A certain pattern does emerge, but I should emphasize that leaders did not plan from the start on a series of summits but rather decided on holding them one at a time.

If we stand back and look at the successive summits, one is struck by a number of points:

- The main economic problems identified by the leaders as requiring their attention have largely been the same mix: low growth, inflation, unemployment, protectionist pressures, the many faces of energy, the North/South dialogue — even though the emphases have varied.

There has been a growing appreciation of the degree of interdependence, both among developed countries and between them and other groups . . . .

- There has been a growing appreciation of the degree of interdependence, both among developed countries and between them and other groups, whether developing as a whole or OPEC in particular. This means that, given the degree of interpenetration of our Western economies — in trade, money markets, and investment, to name only these — domestic policies in any major country have a growing effect on others, and thus no one country can regulate its own economy alone. Accordingly, problems, such as interest rates, economic stimulus or restraint, have to be tackled in concert by the Western countries, although the appropriate-

ness of individual measures will still vary by country. The increase in linkages of summit countries with the oil producers has also been dramatic, whether it is in Western demand for oil and search for markets or OPEC dependence on Western manufactured products and know how and OPEC need for secure and remunerative places to invest. Even with other developing countries, trade and capital links are now of great and growing importance for many summit countries, and market prospects in certain newly industrializing countries are among the most promising anywhere.

- There has been a shift from the rather more short-term, specific, relatively optimistic communiqués of the first few summits to the longer term, relatively realistic, indeed almost dogged mood in the later ones. Summit countries have in fact increasingly appreciated that the issues facing them cannot be dealt with quickly but will be around for some years, that we are in for a period of relatively low growth, high-cost energy, high inflationary pressures, and employment problems. And if one looks ahead to the end of the century — as leaders did at Venice — the prospects, without major policy changes in the meantime, are not encouraging.

- While summits have thus increasingly looked longer term, they also have taken positions on the immediate or the specific, often in great detail. This is so in significant part because leaders have clearly perceived they need to have something concrete to show after such a major meeting. The public focus on these summits has been greater each year (we may have between 1,500 and 2,000 press in Ottawa), and the expectations that are built up are increasingly difficult to satisfy.

- Yet, despite the fact that simply by meeting the leaders have not brought magic solutions to their own and the world's ills — after all, these problems are still with us seven years later — the leaders are continuing to meet. They have found these gatherings a necessary, indeed central, element in their calendars. Summits have increasingly come to play a major role in the calendar of the whole international economic process.

- Not infrequently the communiqués contain language, agreed to by all participants, that on the face of it could be embarrassing at home to one or more participants. The truth is that participants have not been unhappy with such wording. They need the mutual reinforcement to help them either to resist domestic pressures, e.g., for protectionism, or to move in desired directions, such as on energy pricing for the United States.

- The summits have gradually extended their purview beyond the basic economic issues looked at in Rambouillet. At Venice, for example, clearly political issues were raised and communiqués were issued about them, notably on Afghanistan. Terrorism and hijacking have been other such issues, as were refugees at Venice.

- Although no continuing secretariat has been established, an innovative aspect of summits has been the appointment of personal representatives of the leaders. The personal representatives have been charged with following up on one summit and preparing for the next, with the lead taken by the next host country. Also, on energy in particular, follow-up arrangements have been made to monitor progress in implementing the Venice commitments. A recent report on Western consultations by four private policy research institutes underlines the need for systematic preparation of the economic summits and suggests consideration of a small permanent secretariat. I am dubious about this idea; it could tend to "bureaucratize" summits. Leaders will themselves, properly and understandably, want to keep on top of preparations for and follow-up to the summit and keep these closely under their own personal control.

Communiqué reading is something of a specialized, not to say arcane, art. But, read with due care for the nature of the source, the summit communiqués of the past six years well reflect the evolution of informed thinking — the shift from relative optimism to a greater recognition of the intractable long-term nature of the economic problems, a greater acceptance in principle of the reality of interdependence and structural issues. The policy of consultation by leaders has been reaffirmed and strengthened, closer personal relationships have developed among the heads of state, and a readiness has emerged to move toward collective action in some areas. In the process, these communiqués have served to educate the public and thus, perhaps, have had some effect on the expectations of participants in the economy.

. . . economic prospects immediately ahead are at least as sombre as those before any earlier summits. Moreover, the North/South dialogue will be with us in some form or other for many years to come.

The economic summits, in fact, have so far proven to be a positive and helpful addition to the Western world's instruments for managing international problems. They are not seen by the leaders as a "*directoire*," nor could they be. The summit countries must continue to work with their closest friends and partners: in the European Economic Community, in international organizations such as the Organization for Economic Cooperation and Development and the International Energy Agency, and more broadly in the General Agreement on Tariffs and Trade, the International Monetary Fund, the International Bank for Reconstruction and Development — in all organizations that are the policy organs for co-ordinated action. But summits have brought key leaders together in a group that is large enough to have a significant voice in the world yet small enough to make real discussion possible. These gatherings have filled a void. To some extent they have in fact been able to overcome the weight of modern bureaucracies, though there remains a concern about institutionalization of the process, a fear expressed particularly at Venice that the communiqué drafting threatened to take over the discussions. I believe, in short, that the world would have been worse off if there had been no economic summits.

The Ottawa Summit

The summits — although political gatherings in the broad sense — have up to now focused largely on economic issues. These economic issues remain; indeed the economic prospects immediately ahead are at least as sombre as those before any earlier summits. Moreover, the North/South dialogue will be with us in some form or other for many years to come. For this reason, at Venice leaders asked their personal representatives to make a special study of aid and other contributions to developing countries in order to facilitate a solid and substantive discussion of the subject at this year's summit in Ottawa. In doing so, they were conscious of factors of interdependence between developed and developing countries. They had in mind the real interests of summit countries in the economic health and well-being of developing countries — and also in the political stability of those countries in the interests of world peace and security. Of course, it remains true that for summit countries there is an important humanitarian element in the contributions they are prepared to make to the development of countries in the South, and this is as it should be, particularly with respect to the poorest developing countries.

I expect the conclusions from the personal representatives' study will give rise to a substantive and thought-provoking discussion among leaders of summit countries' relationships with developing countries, looking to the future and bearing in mind notably the Commonwealth heads of government meeting beginning in September in Melbourne and the North/South Summit planned for Mexico in late October.This is a subject to which we in Canada continue to attach very great importance.

The international trade situation is frankly worrying, and summit leaders may well want to reflect on how to avoid a destructive protectionist focus on bilateral irritants . . . .

Governments and leaders will need to devote time to other subjects as well. Among the major items I anticipate at this stage for Ottawa's agenda are the tensions between fighting inflation and coping with the implications of the low- or no-growth scenarios foreseen for most summit and other developed countries over coming months, with their significant social and political overtones particularly at a time of growing unemployment in many industrialized states. Recycling of petrodollars and the debt and balance-of-payments needs of a number of significant developing countries are other difficult current issues, although we would hope that the May meeting of the IMF Interim Committee in Gabon will be of help in further improving the system. In this connection we were very pleased at the recent agreement between the IMF and Saudi Arabia under which the latter has undertaken to provide some 8 billion SDR (Special Drawing Rights) in loans to the IMF while IMF members have agreed to a special increase in the Saudi quota in the IMF. This is a good example of recognizing the need to share power where it exists in the South.

The international trade situation is frankly worrying, and summit leaders may well want to reflect on how to avoid a destructive protectionist focus on bilateral irritants — of which we all, unfortunately, confront too many these days — and instead devote their attention to ways of renewing the impetus to expanding world trade in the interests of all participants. In addition, leaders will, of course, need to review progress on the comprehensive energy strategy they agreed on at Venice.

Added to these issues are a number of other difficult and pressing problems of a broadly political or security nature.

As was recognized even before the new U.S. administration took office, the East/West situation has deteriorated markedly in the last fifteen months or so, notably since the Soviet invasion of Afghanistan. The Polish problem does nothing to lessen the tensions. These factors themselves serve to highlight the change in the military situation between East and West brought about over a period of years, particularly by the Soviet increase of its military capacity. The weakening of détente has also had its effects on the North/South equation: there is in some quarters today an inclination perhaps to focus less on problems of the South and more on the East/West issues and to see Southern problems increasingly through an East/West prism. Both sets of issues in fact are important in their own right and would need attention whether the other set existed or not. Clearly, of course, there are many significant linkages between the two, and summits offer one place where a large view can be taken and the broad problems addressed.

Though it should be noted that the USSR's actions have not invariably helped it vis-à-vis the non-aligned, it is also clear that the developed Western countries are far from united on where they should be going or what they should be doing to get there. There are differences of view on strategy and tactics, as came out only too clearly last year over Afghanistan. One could say that there is need for the Western countries to go through something of the same kind of process in these areas as they did during the 1970s on economic subjects: defining the issues, working to develop better understanding and common approaches among them, perhaps even taking steps ultimately toward joint objectives and actions.

At this point, most of the summit leaders are new (or re-elected). Presidents Reagan of the United States and Mitterand of France and Prime Ministers Suzuki of Japan and Forlani of Italy have recently been chosen. President Thorn of the European Community Commission took office as of the beginning of 1981. German Chancellor Schmidt was re-elected last autumn. Because so many leaders are new and since most can look forward to a considerable term of office, it is timely, perhaps essential, for leaders to reflect together on what their objectives are, which are the key issues facing the West, and how these issues should be grappled with. They need to reaffirm their commitment to consultations, to avoid — to the degree possible — unpleasant surprises or unilateralism, especially given the uncertain outlook in such areas as money and finance, trade and protectionism. They may at some point want to go beyond that to set some kind of joint program, as they have done to a degree already on energy, perhaps even to consider possible further arrangements to implement it, recognizing of course that they will need also to continue to work with their partners in existing international forums.

The future of "summitry"

Summit issues are delicate issues, touching national sovereignty, deeply held convictions and ancient traditions. What is the right group? Should the economic summits be broadened to include political issues? Given the political and economic ramifications today of most major issues confronting heads of state or government, whether in the East/West or North/South context, might one not question whether the distinction between "economic" and "political" issues in a summit context is still valid or realistic?

At a minimum, looking ahead, it is hard to imagine that summits in some form are not here for the foreseeable future, despite the risks and *caveats* outlined above. Indeed, if summits did not exist they would probably have to be invented; if they ceased, they would need to be recommenced. Only summit leaders are in a position to take decisions on the web of issues facing the world today; they can cut across lines of authority within their own internal systems and make commitments to broad new directions on the basis of co-ordinated objectives and some degree of equitable burden sharing.

For our part in Canada, we attach a good deal of value to the Western summits. They should continue to be available to do the sort of things they do not now do. They could usefully go further and begin to take what could be called a macropolitical, as well as a macroeconomic, approach.

It is particularly important, from a Canadian point of view, that the kind of consultation and concertation possible at summits be effectively taking place among our closest friends, since we are placed in a very delicate position in the case of persistent and major unresolved differences between, say, the United States and major European Community countries or Japan, on such issues as the monetary problems in the early 1970s, trade issues, or views on the future of détente. We are accordingly anxious to contribute in whatever ways we can to overcome the current differences on economic and political strategy among the industrialized democracies and believe the summits could be helpful in doing so.

In this sense, individual leaders are right to submit themselves at summits to pressures from their peers to move toward mutually shaped goals, to be prepared to "bend" their national "instructions" in favour of a broader interest, and thus to mediate the necessary change to their people. Summits thus do have implications for domestic policy making; but these implications are not always direct and the instruments to be used and techniques to be followed in carrying out understanding reached at summits will necessarily depend on the circumstances of each country.

If these economic summits to date have been able to avoid some of the major potential pitfalls and weaknesses of some other summit meetings, it may be in part because they have not been institutionalized and no permanent secretariat has been set up. They have remained flexible and informal and responsive in large part to the evolving requirements of the heads of state and government. To the extent to which these leaders wish to make a more useful and cohesive instrument of summits, they risk becoming a court of last resort, a forum to which problems are passed up from below and which is seen as a place for decision making on more and more specific items. It is our hope that Ottawa will make its contribution to finding the fine line between over-institutionalization on the one hand and only general discussion on the other, so that Western leaders can make the most of this new diplomatic phenomenon in the interests of their own countries and the rest of the world.

Is a medium-term scaling down of world economic performance the next stage?

The economic situation of the last few years has differed considerably from the environment of the 1960s and early 1970s. The trend rate of economic growth has slowed, inflation has emerged as a major persistent problem and there have been important shifts in the patterns of world trade. Rising relative prices for a number of key commodities — oil and gas, grains and several metals and minerals — have implied wide-ranging changes in the world distribution of income and have necessitated profound readjustments to the mix of output and the methods of production. Public attitudes and expectations have been slow to adapt to these new circumstances and the policy response to them has also been gradual. As the world entered the 1980s, however, there was a growing realization among the major industrialized countries that conditions had changed in several fundamental ways and that new economic strategies were required.

The 1960s and early 1970s were years of virtually uninterrupted growth and prosperity in the world economy. Since 1973, however, there have been two wide-reaching recessions and the underlying growth potential of the industrialized economies has been sharply reduced. World population expansion has led to some developing resource shortages and these in turn have caused price shocks and increased cyclical instability. Environmental protection has also become a larger and more urgent issue. Productivity growth has slowed and living standards have not improved at the rapid rate enjoyed in earlier years. In short there has been a reluctant but increasing acceptance of the view that the economic growth aspirations of the 1960s and early 1970s are no longer achievable and that a significant scaling-down of performance targets is needed for the 1980s.

Excerpt from *Economic Review*, April 1981, Department of Finance.

Coming to Grips with World Stagflation

Policy-makers not only must come to terms with the strained bedfellows of slow growth and rising inflation but must also confront such issues as petrodollar recycling and rising energy prices

by Lawrence A. Veit

The heads of state of the seven major industrial countries bear particularly weighty responsibilities for assuring world economic prosperity when they meet in Ottawa in July.

The current position of the world's leading economies is in many ways similar to the post-1973 period. With the notable exceptions of Britain on the downside and Japan and Australia with strong growth, stagflation is the most applicable description. In 1980 most nations avoided serious declines in the pace of economic activity, but they may require considerable time before they can restore production to previous peak levels. Moreover, even though national inflation rates in 1980–81 generally show less sharp upward spikes than in 1973–74, they have been uncomfortably high and resistant to decline. Balance-of-payments deficits and surpluses have been very large nominally, but after adjusting for inflation, the current figures appear no worse than those recorded in 1974. Reflecting these underlying economic developments, stock, bond, and foreign exchange markets have been erratic and volatile.

The questions confronting policy-makers are also similar to those prevailing in the post-1973 period. Most important: Can petrodollar recycling be managed without major casualties? Will energy markets continue indefinitely to reflect supply shortfalls and rising prices? Is it inevitable that the coincidence of major economies in recession will itself lead to further weakness? Can an open climate for international trade and investment be maintained?

Many countries appear to have learned from the earlier situation and are acting more prudently than in the past. Even so, the problem in 1981 may be more difficult to manage since inflation has become more entrenched; the number of unemployed in most countries is much higher than seven years ago; the credit standings of individuals, companies and countries have been weakened; and protectionist forces are growing stronger. In short, remedies that worked previously may be losing some of their potency. If the world economy is to regain its health, it must receive not only a booster shot of the old medicine but a new dose of imaginative and sound public policy that in some instances may promise greater stimulus through a lessening, rather than an enlarging, of government involvement in the economy. Table 1 shows real growth, inflation and international payments for the leading world economies.

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Recession spreads

Contrary to the consensus forecast a year ago, many of the European economies began receding only one or two quarters behind the United States. With the exception of Britain, however, most European countries were able to maintain small positive real growth rates in 1980. On average, European gross national product (GNP) grew by 1 per cent. Nevertheless, the dislocation caused by the slowdown is very much understated by year-on-year GNP comparisons. For example, the reported German real growth rate of 1.8 per cent in 1980 disguises a 70 per cent rise in unemployment in the seven months from June 1980 to February 1981 (from 3.3 per cent of the work force to 5.6 per cent). Similarly, the British GNP growth rate in 1980 (−3.0 per cent) does not indicate that the index of manufacturing production is currently 16 per cent below the peak reached in June 1979, at a level last seen in early 1968. The GNP data are also misleading in that they do not suggest such adverse developments as the widespread decline in company profits and the slowdown in investment spending.

Japan is unique among the leading world economies in having maintained a substantial real growth rate in 1980 (5.5 per cent). Assuming that the current economic situation will not be upset by an unexpected crisis, the Japanese may be able to

achieve a further 3.5 per cent or more GNP growth in 1981. To obtain these growth rates while, at the same time, keeping inflation below the Organization for Economic Cooperation and Development (OECD) average, Japanese government policies have had to meet two difficult tasks: (1) raising nominal income of consumers just enough to improve real incomes and consumer expectations but not so much as to cause excess demand, and (2) balancing the transition from exports and investment as the leading sectors of the economy to a more heavy reliance on domestic consumer demand and public investment.

The United Kingdom is also unique insofar as its recession has not only been deeper and lasted longer than other countries' but promises to remain severe through most of 1981. The fiscal 1981 budget, presented by the Thatcher government on March 10, reduced interest rates modestly but raised taxes and promised to continue a rather firm monetary policy. Its effect on the domestic economy will be to curb consumer demand and further weaken the business sector. Abroad, unless sterling's exchange rate is depreciated, Britain can look forward to deteriorating trade and current account positions. In many ways the problem is illustrated by the situation of Britain's biggest manufacturing firm, Imperial Chemical Industries (ICI). Despite reductions in the size of its work force and other cost-cutting measures, weak demand for its products has caused ICI to show the first quarterly loss in its history and to reduce its dividend for the first time since the Great Depression.

Two other important exceptions to the European growth pattern are Australia and Canada, countries that are alike in the plentitude of their natural resource endowments but very different in their public policies. Australia, by improving the position of private business and encouraging resource development, was able to record a 2.3 per cent real growth rate in 1980 despite poor weather; it is likely to accelerate growth to 3.0 per cent or more in the current year. In contrast, Canada saw its GNP growth fall to 0.1 per cent in 1980, and an increase of only

Table 1
Forecast for 1981

	Real GNP (% change)				Consumer prices (% change)				Current account balances[1] ($ billions)			
	1978	1979	1980E	1981F	1978	1979	1980E	1981F	1978	1979	1980E	1981F
OECD, total	4.1	3.6	1.2	1.3	7.9	9.8	12.2	10.0	10.0	−35.0	−71.9	−53.0
United States	4.8	3.2	−0.2	2.5	7.7	11.3	13.4	10.7	−14.3	−0.8	0.1	−7.0
Other OECD	3.6	3.9	2.0	0.6	8.0	8.9	11.5	9.6	24.3	−34.2	−72.0	−46.0
Canada	3.4	2.8	0.1	2.0	9.0	9.1	10.1	11.5	−4.4	−4.4	−1.5	−4.0
Japan	6.0	5.9	5.5	3.5	3.8	3.6	8.1	5.5	16.5	−8.8	−10.8	−2.0
United Kingdom	3.0	1.0	−3.0	−2.5	8.3	13.4	18.0	13.0	1.5	−4.8	6.4	2.0
Germany	3.5	4.5	1.8	0.3	2.7	4.1	5.5	4.8	8.7	−5.5	−16.5	−8.0
France	3.8	3.3	1.5	0.4	9.1	10.8	13.6	12.0	3.7	1.2	−7.3	−5.0
Italy	2.6	5.0	2.8	0.0	12.1	14.8	21.0	18.0	6.2	5.1	−7.0	−3.0
Belgium	3.0	2.1	1.5	0.1	4.5	4.5	6.7	6.5	−0.9[2]	−3.8[2]	−6.0[2]	−6.0[2]
Netherlands	2.1	2.3	1.2	0.3	4.1	4.2	6.5	6.2	−1.4	−2.3	−3.0	−2.0
Sweden	1.6	3.8	2.2	0.5	10.0	7.2	13.7	12.5	−0.3	−2.6	−5.1	−4.0
Spain	2.5	1.5	1.7	1.5	19.8	15.7	15.1	17.5	1.6	0.9	−4.5	−4.0
Australia	2.8	2.8	2.3	3.0	7.9	9.1	10.1	9.5	−4.0	−2.0	−1.8	−2.5
OPEC	2.7	2.9	2.2	4.0	10.6	10.4	12.0	10.0	4.5	68.0	110.0	80.0
Non-OPEC LDCs	5.0	4.6	4.5	3.0	24.5	29.4	35.0	32.0	−22.5	−37.0	−50.0	−45.0
Mexico	7.3	8.0	7.5	7.0	17.5	18.1	26.0	28.0	−2.4	−4.2	−3.0	−3.0
Brazil	6.0	6.4	4.5	3.0	38.8	52.8	82.8	90.0	−7.2	−10.4	−12.0	−10.0
Argentina	−3.4	8.5	0.0	3.5	175.5	159.5	100.8	80.0	2.2	0.2	−2.8	0.0
Other countries & statistical discrepancy	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	8.0	4.0	11.9	18.0

E = Estimate.
F = Forecast.
N.A. = Not Available.
[1]Includes official transfers.
[2]Includes Luxembourg.
Sources: OECD; IMF; Brown Brothers Harriman & Co.

2.0 per cent is anticipated in the current year. The U.S. and global recessions were partly responsible for Canada's slowdown, to be sure, but domestic factors such as government policies that weakened home building and business investment were also very important. In particular, Canada's National Energy Program, proposed in October 1980, appears to have affected investment adversely, and unless modified, the economic costs of this energy policy may ripple through the entire economy for years to come.

Taking all the industrialized countries except the United States as a whole, real growth fell from 3.9 per cent in 1979 to 2.0 per cent last year and is forecast to be only 2.5 per cent in 1981. Two factors are most responsible for the slowdown thus far. First is the negative transfer of purchasing power to oil-exporting nations implicit in the 65 per cent jump in average Organization of Petroleum Exporting Countries (OPEC) oil prices in 1980. Second, in contrast to the post-1973 period, are the rather cautious monetary/fiscal policies governments have been pursuing to restrain inflation. Because petroleum prices were still rising at the beginning of 1981 and governments have hesitated to adopt more stimulative economic policies — especially in the light of high U.S. interest rates — the next upward phase of the business cycle may be delayed for most countries until the second half of 1981 or early 1982. When the recovery comes, moreover, it is likely to be meager by historical standards. In particular, it may be slowed by some loss of exports to the many less-developed countries that are now finding it necessary to retrench in the face of rising oil import costs and steeply rising external debt service burdens.

Rising prices: universal problem

High and accelerating inflation has confronted virtually every country in the world in the past several years. The common cause is the steep increase in petroleum prices. According to the OECD, each 10 per cent rise in OPEC prices increases the energy component of the average consumer price index by about 4 per cent and raises the total domestic GNP deflator by roughly 0.5 per cent. Thus, the dramatic rise in oil prices since early 1979 may have added almost 10 percentage points to the overall inflation rate during the two-year period through 1980, even more than during the first oil shock that followed the October 1973 war.

In other respects, however, the current inflation situation is unlike the early 1970s.

- The 1973 commodity price boom has not been repeated with the same intensity. But even though inventories of selected agricultural and industrial goods are relatively small, commodity prices have been weakened by the dismal outlook for real GNP growth, high interest rates, and the attraction of alternative investments. Thus, unless supplies of raw materials can be increased rapidly when demand growth resumes, commodity price inflation may recur.

- Nominal wage increases in 1979–80 have not been as large as might have been expected from past wage reactions to rising consumer prices. Accordingly, unless hourly labour compensation rates continue to rise strongly after the major petroleum price hikes abate, consumers in the oil-importing countries will have adjusted to the new terms of international trade and the reduced real purchasing power of their incomes more readily than in the post-1973 period. Guarded optimism for some moderation of inflation is justified by considerations such as: (1) the Japanese "spring wage offensive" is likely to lead to only a 6–7 per cent increase, (2) one German labour union has already settled in 1981 for a 4 per cent wage increase, (3) a number of governments have adopted measures to curb the rise in labour costs, and (4) signs that workers, management and government in the United States are increasingly recognizing the need to better the country's international competitive position by improving the unit labour cost performance through actions affecting both labour compensation and productivity.

- Although most nations have had somewhat firmer monetary and fiscal policies during the current recession than on past occasions, labour markets appear to have become less responsive to rising unemployment. Thus, despite the favourable omens just noted, the general momentum of high wage and price inflation is dangerously strong, likely to last for an extended period, and subject to aggravation by new energy or other "shocks."

- The appreciation of the U.S. dollar has worsened inflation in many countries other than the United States by increasing the cost of dollar-priced goods, notably oil, entering into international trade. As noted below, the potential for a further major appreciation of the dollar relative to the German mark and a number of other currencies is now quite low, reducing the probability that this factor will be as important in the future. Indeed, modest depreciation of the dollar could help other countries in their struggle against inflation.

On balance, as a result of the above considerations and the likely slowing in the pace of oil price hikes, inflationary forces will continue to be powerful but some deceleration in the rise of consumer prices is probable for most countries. For the OECD as a whole (excluding the United States), the average CPI may climb 9.6 per cent in 1981, moderately less than the 11.5 per cent recorded last year. Disparities in inflation rates are projected to be very large in 1981, ranging from a low 4.8 per cent in Germany to 18.0 per cent in Italy. The United Kingdom is the one country that appears to have made considerable progress in curbing inflation, especially in recent months. This has been achieved at an enormous cost in lost production, however, and the eventual return of positive GNP growth in Britain may rekindle double-digit price increases.

Balance-of-payments difficulties

The emergence in 1980 of an estimated $110 billion OPEC surplus in the current account of its balance of payments had its counterpart in uncomfortably large deficits in most of the oil-importing nations. The only major industrial countries to record current account surpluses in 1980 were Britain and the United States. The non-OPEC less-developed countries, despite their efforts to pare non-essential imports and spur exports, together

recorded a current payments deficit of about $50 billion in 1980, up from $37 billion the previous year.

Britain and the United States were notable exceptions among the industrialized countries, recording current account surpluses estimated at $6.4 billion and $0.1 billion respectively. The U.K. surplus is easily explained: domestic oil output rose; inventories were liquidated; and the severe recession reduced imports and spurred exports despite a remarkable appreciation of the pound sterling. Because Britain's oil production is still increasing, balance-of-payments weakness may not recur before the second half of 1981; a modest $2 billion surplus is forecast for the current account this year.

In contrast, the slight U.S. surplus in 1980 was aided by a major reduction in the volume of oil consumption and imports. In addition, currency depreciation in preceding years appears to have improved the country's competitive position, lifting exports and, together with the domestic slowdown, dampening imports. The U.S. current account surplus will probably be short-lived: (1) the scope for reducing the volume of oil imports is not as great in 1981 as last year; (2) the dollar has appreciated relative to most major currencies; (3) the U.S. economy will probably strengthen sooner than its trade partners' economies; (4) Germany, France and other industrial countries with large payments deficits can be expected to compete especially fiercely for world markets; and (5) many oil-importing less-developed countries are encountering financial constraints that are likely to reduce their demand for U.S. exports. Moreover, the growth of dollar-reported earnings of U.S. firms operating abroad may be restrained temporarily by the impact of the global economic slowdown on output volumes and profit margins, as well as by the dollar's high valuation. In sum, the U.S. current account may record a $7 billion deficit in 1981.

As the U.S. and British payments positions weaken, Japan, Germany and many other nations are expected to grow stronger. It may be possible to reduce the OPEC current account surplus to $80 billion if (1) increases in Iraqi and Iranian crude production are not more than offset by Saudi Arabian and other country cutbacks; (2) OPEC demand for imports of civilian and military goods continues to grow rapidly; (3) the OECD economies remain sluggish; and (4) no new economic or political shocks emerge to upset the supply/demand balance that is currently restraining the price of oil. For many of the industrialized countries the key to better balance-of-payments results is currency strength vis-à-vis the U.S. dollar: in many cases, painful monetary and other policies have therefore been adopted.

Less-developed countries, too, have been forced to restructure their economic targets in the direction of lower real growth in order to curb balance-of-payments deficits. In addition to the well publicized increases in oil import costs and the foreign debt burdens of developing countries, a significant deterioration can be observed in the international reserve positions of these nations. The problem affects not only a number of very poor countries but also some of the larger semi-industrialized states.

Brazil, for example, has seen its foreign exchange reserves slip from $11.4 billion in the fourth quarter of 1978 to $4.8 billion in October 1980. Accommodation to help Brazil and other countries bridge the current payments gap is available to some degree through the International Monetary Fund and elsewhere. It is well recognized, however, that countries wish to own reserves and that access to borrowing is not a full substitute for ownership. In addition, with the prospect of continuing imbalance in the world's payments system and the now apparent need to restructure Poland's $25 billion external indebtedness to Western lenders, the international banking system may not be able or willing to play as large a role in petrodollar recycling as it has in the past. The problems of less-developed countries will be compounded to the extent that the recession in industrialized countries continues, weakening export earnings of less-developed countries by lowering both commodity prices and the volume of exports.

Outlook and exchange rates

Experiments with "benign neglect," "dirty floating" and other approaches to foreign exchange management have done much to publicize the importance of exchange rate movements to changes in economic and financial structures, domestic and international. Nonetheless, the exchange markets are today characterized by at least as much volatility as in the past and also by rates that do not always appear to reflect economic and financial fundamentals. Throughout most of 1980, interest rate differences were the key factor determining exchange rates. More recently, the focus of the markets has turned, but rather than featuring basics such as inflation rate differentials and balance-of-payments positions, the markets have fixed on an amorphous mix of political considerations, ranging from Poland to President Reagan's program of supply economics. As a result, the dollar has demonstrated a remarkable amount of strength in the past several months, a situation that may be modified in the course of 1981.

For Germany, Switzerland and a number of financially related countries, some strengthening of their currencies vis-à-vis the dollar would be very welcome. Although the leaders of many of these countries urged the Carter administration to adopt a firm monetary policy to fight inflation, they did not foresee the extent to which high U.S. interest rates would strengthen the dollar and require high interest rates throughout most of Europe, both to brake their currency depreciation and to maintain parity relationships within the European Monetary System (EMS). A strong dollar, while it helped the international competitive position of European industry, became unwelcome because it raised the cost in local currency of oil and other dollar-priced imports, increasing inflationary pressures. The high interest rates now prevalent in Europe, moreover, are not appropriate to the general economic weakness. Thus, the Europeans have reversed position and have strongly urged the United States to ease its monetary policies. In fact, however, U.S. interest rates soared in late April and early May. It is probable that weakness in the U.S. economy and new perceptions of improvement in the U.S. inflation rate will begin to gradually reduce U.S. interest rates. These forces and the weakening balance of payments situation at a time when Germany's external position is strengthening could lay the basis for a 5 per cent or more appreciation of the German mark and other low-inflation currencies. In contrast, the French franc and Italian lira might not benefit fully from such a development, and these relatively high-inflation currencies may become increasingly difficult to defend within current EMS boundaries.

The United Kingdom's currency situation is unique. After falling to under $1.60 in late 1976, sterling recovered and traded

above $2.40 in January 1981. Its strength was due to high interest rates, rising oil production, the impact of the severe recession in improving the balance of payments and, more recently, a declining inflation rate reflecting favourably on the policies of the Thatcher government. The positive sentiment has been so strong that sterling has lost barely more than $0.30 recently, even though the monetary growth rate has overshot its target, the public sector borrowing requirement is well above the fiscal 1981 budget forecast, interest rates are moving lower with more declines possible, the government has capitulated to the miners and other labour groups, and the government retreated from its desired policies when it decided to prop up sick companies. Although the potential for downward pressure on sterling is clear, the currency may stay level or even rise in coming months. The likelihood is that any notable depreciation will be delayed at least until late 1981, when a shift from negative to positive real economic growth may rekindle inflation and also worsen Britain's trade and current account balances.

The Japanese yen has been quite stable for the past four months, especially compared with the preceding tidal movements that strengthened its average rate from Y286/$ in the first quarter of 1977 to Y190/$ in the fourth quarter of 1978, returned it to Y252/$ in April 1980, and subsequently bolstered it again to Y211/$ in the fourth quarter of 1980. Although Japanese interest rates are well below rates in most other industrialized countries, the medium- and long-term prospect is for further yen strength: the inflation rate has been better controlled in Japan than elsewhere; the balance of payments is improving due to reduced oil consumption and an export competitiveness that is likely to be only slightly undermined by foreign protectionism; and the rising attraction of Japanese investment markets to foreign asset holders will bolster capital inflows.

In contrast, the Canadian dollar has been unable to benefit from a very strong foreign trade performance. The exchange markets appear to be concerned about inflation in Canada and the probability that the trade and current account positions will take a sharp turn for the worse when real economic growth resumes. Still more important may be concern about the mischief that economic policy, as exemplified by the proposed National Energy Program (NEP), may do to the economy and financial markets. The NEP has already caused important financial losses in the energy sector, and Alberta has protested against Ottawa's energy policy by making the second of three major cutbacks in oil production. As seen by the markets, Canada's economic policies may prevent the exchange rate from rising much above current levels.

Investment implications

Rising short-term interest rates in many countries — Japan and Britain are notable exceptions — weakened bond markets toward the end of 1980. In addition, inflation, recession and high interest rates have reinforced one another, narrowing company profit margins and, especially in Europe and North America, leading to declines in earnings and even reductions in dividend rates. Consequently, some of the dynamism that characterized numerous equity markets in much of 1980 has evaporated. The German market has remained in the doldrums. Until recently, the normally buoyant Tokyo stock market has been hurt by global stagflation and only a select group of Japanese stocks were continuing to show strength. Australia has seen a major correction in equity prices, even though the Fraser government has been re-elected and the inflation rate is declining.

In short, the investment climate has been difficult in recent months, as consumers in many Western countries have chosen to consume rather than save and as a high level of uncertainty has inclined many investors either to hold real assets or to prefer liquid, fixed-income assets over stocks and bonds. This situation, together with firmer monetary and fiscal policies that governments are now following, is partly responsible for the emergence of positive real yields, as indicated in Table 2.

Table 2
Inflation-Adjusted Return on Capital
(Percentage)

	Change in Consumer Price Index[1]	Return on three-month money[2]	Real rate of return
United States	10.6	14.0	+3.4
Canada	12.4	17.0	+4.6
Japan	6.2	7.5	+1.3
Germany	5.4	13.4	+8.0
Netherlands	6.6	10.4	+3.8
Switzerland	6.3	7.7	+1.4
United Kingdom	12.4	12.7	+0.3

[1]March 1981/March 1980.
[2]End of March 1981.
Source: Brown Brothers Harriman & Co.

To the extent that inflation rates in most countries are forecast to decline in 1981, nominal and, in some cases, real interest rates may also move lower. Although other important variables will affect the capital markets, this may provide the basis for strengthening bond prices and a subsequent rise in stock markets, at least for countries with strong exchange-rate prospects.

The precondition for any sustained confidence in the long-term investment outlook, however, involves an improvement in the underlying economic and political environment. Investors need some assurance that any reduction in inflation will be lasting; that even if there is a simultaneous recession affecting the leading world economies, governments will avoid both deflationary policies that would intensify the recession at home and trade protectionism that would worsen recession elsewhere; that progress is being made in reducing the West's dependence on the oil-exporting countries; and that public policies will recognize the legitimate needs of business as well as social aims. The world economy is now somewhat out of normal pattern, presenting both dangers and opportunities to national leaders as they seek to balance domestic and international goals. Thus, it is a time when the far-reaching structure of international co-operation, developed over the past 35 years, appears to offer unusual opportunities for addressing not just world but domestic economic problems.

Macroeconomic Issues Facing Ottawa Summit

The seven leading industrial nations meeting in Ottawa at the seventh economic summit will discuss why growth in real output is strongest and unemployment is less when inflation is controlled

by Michael Parkin

The economic summits that began at Rambouillet in 1975 have become annual occasions on which the heads of state of the seven biggest Western powers review recent and prospective economic developments, exchange views on what they see as the major problems and issue broad declarations identifying those problems and affirming their commitment to finding and achieving solutions to them. The summits are not, and in their nature cannot be, occasions for detailed microscopic analysis of the world's economic ills. Rather, they are, as their name suggests, a time to stand above the minutia and take the broad view.

What are some of the major issues the world faces as we approach the seventh summit, to be held in Ottawa July 20 and 21, 1981? While there is room for differences of opinion concerning the most important economic issues, it seems likely that the items that dominated the Venice Summit one year ago are likely to remain high on the agenda in 1981. According to the Declaration of the Venice Summit, "The economic issues that ... dominated our thoughts are the price and supply of energy and the implications for inflation and the level of economic activity in our own countries and for the world as a whole." The declaration went on to identify "the reduction of inflation ... [as the] immediate top priority" and to assert that "determined fiscal and monetary restraint [would be] required to break inflationary expectations."[1]

The developments in inflation and real economic activity in the past year assure these problems a leading place in the 1981 Ottawa Summit discussions. Here, we examine the economic performance of the seven summit nations, focusing on their inflation and real economic growth performance over the years since summitry began in 1975. We also look at the monetary and fiscal policies that have been pursued in these countries, seeking to identify the major influences on the course of inflation and real output growth and on the way in which national economies have reacted to the sizeable energy price shocks administered at various times over the last few years. Then we go on to ask what lessons have been learned from the economic performance of these seven major countries since 1975 and finally briefly review the policy choices that confront us.

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[1] "Declaration of the Venice Summit," *Economic Summits 1980–1975, Communiques & Statements*, Tab 1, p. 2.

Across the summits

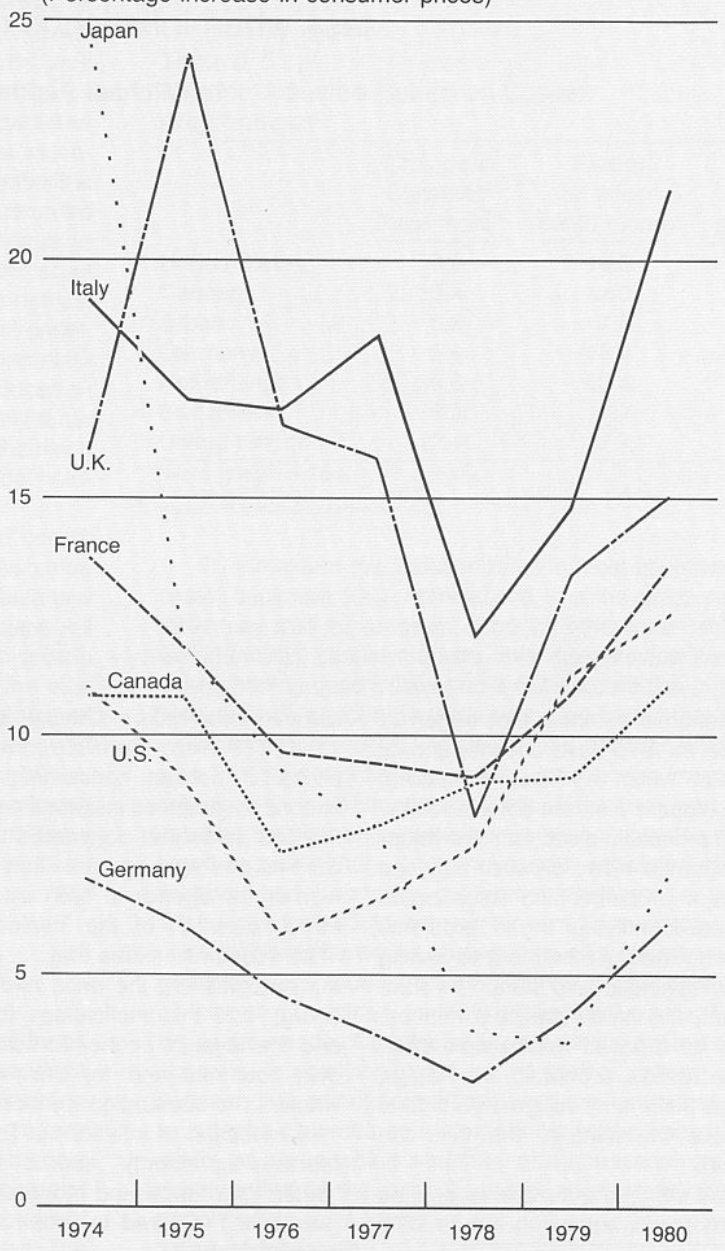
The inflation record of the seven summit nations is set out in Chart I. It shows a familiar and rather disconcerting picture. The starting year on the chart, 1974, was of course the first full year after the fateful quadrupling of the price of oil in the fourth quarter of 1973. It was a year in which, with the exception of Germany, all the major countries rocketed into double-digit inflation. The worst affected was Japan, which hit an almost 25 per cent annual inflation rate. In the two years up to 1976, inflation rates fell in all the countries (with the exception of the United Kingdom, where there was a subsequent burst of inflation in 1975). Beyond 1976, however, national experiences began to diverge again. Some countries — Germany, Japan, France, U.K., and Italy — continued to experience falling inflation all the way through to 1978. The United States and Canada, however, reached a trough inflation rate in 1976 and gradually began to inflate more quickly in the two years through 1978. The last two years, 1978–79, saw all inflation rates turn up again and, with the exception of Japan, to levels very close to those experienced in 1974.

With the notable exception of Japan, inflation rates have gone almost full circle.

Thus, with the notable exception of Japan, inflation rates have gone almost full circle. The most striking and encouraging feature of the facts presented in Chart I concerns that exception, Japan. In Japan the inflation rate fell successively through five years from almost 25 per cent to reach a low of 3.7 per cent in 1979. The rebound in inflation, although substantial, still leaves Japan with an inflation rate of less than one third its 1974 rate. Turning to real output growth, Chart II reveals a similar and equally disconcerting pattern of events. As with Chart I, the most striking feature of the real output growth developments is that the Japanese experience does not fit the pattern established by the other six. Japanese real output growth began very low in 1974 and gradually climbed through 1976 to a peak of 6 per cent. In the four years since then, Japanese real output growth, while declining slightly, has basically stayed in the 5 to 6 per cent per annum range. The other six countries shared in Japan's strong recovery from the 1975 recession to achieve moderate-to-high growth rates in 1976. With the exception of the United States, they all slipped into a much more modest growth rate in 1977, recovered slightly in 1978–79, and in 1980 moved into a recession as deep as or, in the cases of the United Kingdom and Canada, even deeper than the 1975 decline in the growth of real output.

Looking at the developments in inflation and real output growth together highlights a most remarkable fact. The countries whose real output growth has collapsed in 1980 to rates comparable to those of 1974–75 are precisely the countries whose inflation rates have accelerated

Chart I
Inflation Across the Summits
(Percentage increase in consumer prices)



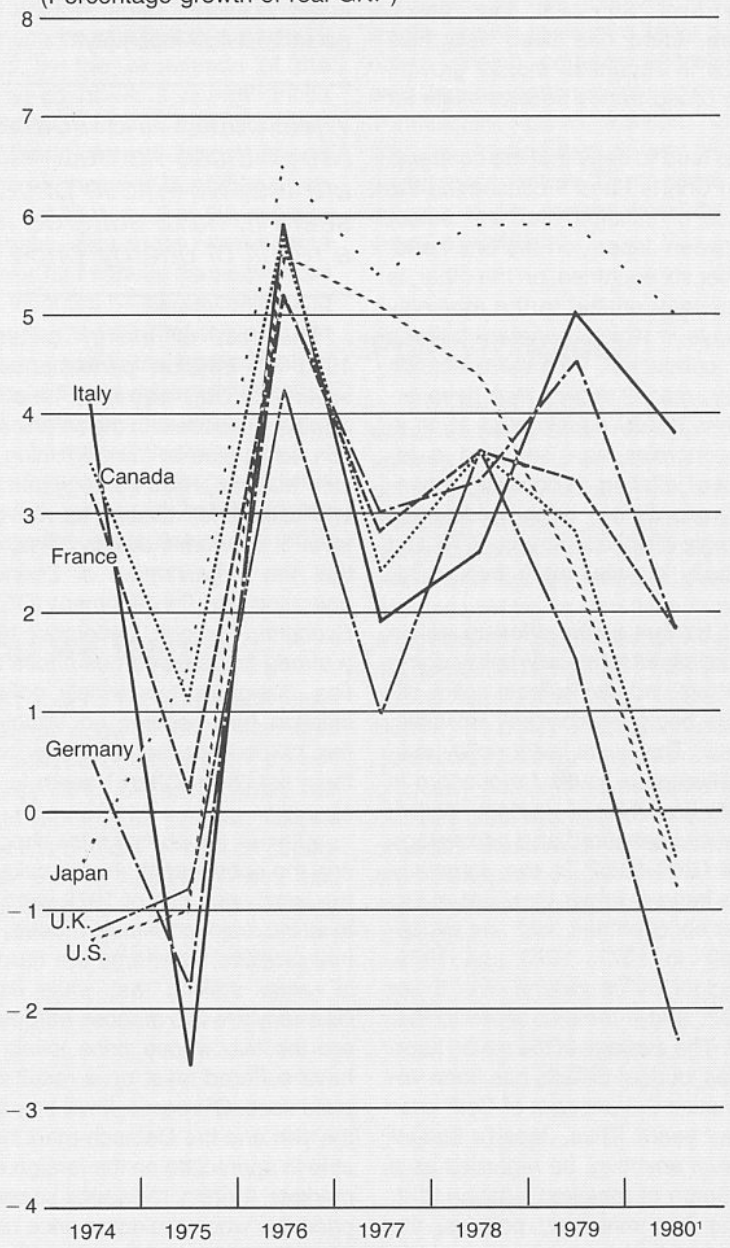
Sources: OECD, *Economic Outlook*, December 1980; *The Economist*, February 7, 1981.

back to the 1974 level. Only Japan seems to have systematically reduced inflation to modest proportions in comparison with its 1974 experience and only Japan has raised its real output growth rate and avoided a further collapse of real output growth in the last year. It would seem that there is a most important lesson to be learned here: there is no "cruel dilemma" between generating economic growth and containing inflation. In the words of the Declaration of the Venice Summit, "inflation retards growth and harms all sectors of our societies."[2] The evidence for that proposition is displayed so starkly and simply in the patterns recorded in Charts I and II.

Recognizing these facts, it is hard to sustain the myth often perpetrated by politicians and professional economists alike that there is a cruel trade-off between inflation and real economic growth or between inflation and unemployment. Evidently, to the extent that there is such a trade-off, it is an extremely transient and short-run phenomenon. Viewed over the span of just a few years, the trade-off vanishes. Real output growth is strongest and unemployment is mildest in situations in which inflation is eradicated with speed and conviction.

[2] *Ibid.*

Chart II
Output Growth Across the Summits
(Percentage growth of real GNP)



Source: OECD, *Economic Outlook*, December 1980.
[1] 1980 figures are provisional.

Although the patterns in the development of inflation and real output growth in the seven major countries lead inexorably to the conclusion that there is no cruel trade-off, they do not tell us wherein lies the source of the successful avoidance of inflation and the sustaining of high levels of output growth and low levels of unemployment. Discovering the sources of success in these matters is harder than cataloguing the success where one sees it. Let us, however, turn to an examination of the monetary and fiscal policies pursued by the six "full-circle" countries and by the Japanese to see whether there are any obvious pointers.

Monetary/fiscal policies

All seven summit countries have set targets for monetary growth since the middle 1970s. They have not, however, pursued their targeting with the same degree of vigour or precision. In the United Kingdom, monetary targets have been set for a very broadly defined monetary aggregate. The targeted growth rates have been reduced gradually, but there has been an inordinate amount of "base drift" (the tendency to redefine the base from which the target growth rate is measured).

Viewed as a whole over the last four years, there has been virtually no monetary restraint in the United Kingdom, at least as measured by the growth rate of the broad aggregate, sterling M3. Further, monetary growth has been quite erratic in the United Kingdom, so that it has been hard for rational decision makers to form a clear view as to where Britain's inflation is headed.

The other very high-inflation economy, Italy, has pursued a monetary policy with more predictability than that of the United Kingdom, but its policy is one of extreme gradualism, maintaining growth rates of domestic credit at close to 20 per cent per annum over the past four years.

France, with at present the third highest inflation among the seven nations, has been targeting on a broad monetary aggregate but has maintained an almost constant target growth rate at 11 or 12 per cent per annum over the last four years.

U.S. money supply targets have been defined on a variety of aggregates, but the actual performance of money growth has been highly erratic and on the average quite strongly inflationary over the last few years. Targets have been missed and revised upward, and the growth rates measured on a monthly or quarterly basis have been highly volatile.

Canada has pursued narrow money growth targets (M1) and has broadly achieved or undershot its targets since targeting began in the middle 1970s. Like the United States and United Kingdom, however, monetary growth rates in Canada have been highly volatile. Furthermore, Canada, in company with the United States, has seen a sharp rise in short-term interest rates, with the result that the velocity of circulation of narrow money has increased very strongly. Broader monetary aggregates in both Canada and the United States have increased at virtually a constant and quite highly inflationary rate over the last few years.

The countries whose real output growth has collapsed in 1980 to rates comparable to those of 1974–75 are precisely the countries whose inflation rates have accelerated back to the 1974 level.

In summary, all five of the countries whose inflation rates have returned to levels very close to their 1974 levels have pursued monetary policies that have been loose, erratic, and in contradiction to previously declared monetary growth targets.

Two countries stand out as not fitting this pattern, Germany and Japan. In Germany, central bank money (an aggregate that is very closely correlated with broad money) has grown at a slightly decreasing rate over the last four years. Furthermore, German monetary growth has been reasonably smooth and predictable. The rate of deceleration of money growth in Germany has, however, been modest. This no doubt accounts for the bounce back in German inflation to almost 6 per cent over the past two years.

In the case of Japan, the growth rate of a broad money supply (M2) has been controlled to achieve targets that have been successively reduced from 12 to 10 per cent over the past four years. Before that, Japanese money growth was in the high teens and low twenties, so that at the beginning of targeting in Japan, there was a dramatic drop in money supply growth. The Bank of Japan has achieved its money growth targets or has undershot them systematically over the past four years. Furthermore, there has been very little randomness in Japanese money growth, so that the broad trends become plain for all to see.

It seems hard to deny that the contrasts revealed in Charts I and II concerning the performance of inflation and real output growth between Japan, on the one hand, and the other six countries, on the other, is not in some way related to the markedly different ways in which monetary policies have been conducted. With the exception of Germany, money growth has been erratic and has hardly decelerated at all in the five economies now suffering a renewed bout of inflation. In contrast, Japanese money growth has been predictable; it was strongly disinflationary in 1975 and then gradually disinflationary ever since then.

Could it be that in the effort to define Japan's successful monetary policy some more important underlying fiscal policy differences are being overlooked? Possible, but not likely. The usual fiscal policy indicator identified as a cause for concern is the overall government budget deficit. Japan's deficit, measured as a percentage of nominal GNP (GDP in the Japanese case), is as large or larger than that of any of the other six countries, with the exception of Italy. In 1977, 1978 and 1979, Japan's budget deficit rose to over 5 per cent of GDP, and it remains close to that level today. The average of the seven summit countries' budget deficits has been virtually a constant 2.5 per cent of GNP over the past four years. Thus, Japan's budget deficit must, if anything, be regarded as a potential source of renewed inflation. Yet, by pursuing firm monetary policies, the Bank of Japan has demonstrated an ability to squeeze out inflation.

Another feature of fiscal policy that undoubtedly works to the advantage of the Japanese authorities concerns the small fraction of gross national product spent by the government. In this respect Japan is lower down the scale than the other six countries. This suggests the importance of the programs being pursued particularly by President Reagan and Prime Minister Thatcher to reduce government's economic role in their respective countries. It also suggests that minor tinkering with the scale of government is probably going to have limited effect. To get down to the Japanese level of government involvement in the economy would require incredible acts of political ingenuity.

While Japan and Germany are two of those hardest hit, they are the two whose price levels seem to have suffered least as a result of energy price rises.

The role of energy prices in the 1975–80 inflation performances of the seven countries also must be considered. The seven leaders in their Venice Declaration, as quoted at the beginning, took the view that the price of energy had important implications for inflation as well as for the level of economic activity. Also, it is clear that the Organization of Economic Co-operation and Development (OECD) (see *Economic Outlook*, December 1980) sees a strong link between oil prices and inflation. Although it is widely believed that inflation has become so troublesome in the 1970s because of energy prices, the facts set out in Chart I seem to deny this strongly.

After all, the energy price shock of 1973 and the subsequent shocks culminating in the large price rise of 1979 were common to all the major countries. Indeed, countries that produce no energy are hardest hit. It is rather striking that while Japan and Germany are two of those hardest hit, they are the two whose price levels seem to have suffered least as a result of energy price rises. Of course, it will be argued that the yen and the Deutsch-mark have been able to appreciate on the foreign exchange markets, thereby mitigating some of the oil price rise when the dollar price rise is converted into yen and D-marks. That is true; but it also entirely misses the point that the foreign exchange value of a currency is

determined by the degree of firmness of the monetary policies being pursued by the central bank in question.

To summarize, the monetary policies pursued by Japan over the past six years have led to a sustained eradication of inflation in Japan, but in the other countries they have been too passive, not enabling inflation to be squeezed out. Fiscal policy variations, at least regarding the overall budget deficit, does not seem to be a serious inflationary factor. It is possible, however, that the scale of government spending is important.

The proposition that the price of energy is the major source of inflation is emphatically denied by the experience of the seven summit countries. If energy prices were the central problem, Japan and Germany would surely have inflation rates at least as high as those of the other countries. This is not to deny that the successive and sizeable rises in the relative price of energy have had serious consequences for the real incomes of the oil-consuming nations. Nor is it to say that the average growth performance in the second half of the 1970s has not been adversely affected. Further, it is not to say that there is not a temptation, and indeed in some cases a tendency, for inflationary monetary policies to be pursued, which to some degree accommodate the initial rise in the price of oil.

What do we learn?

The main lessons are simple and clear. First, Japan has done better on the fronts of inflation and real output growth, as well as of employment. Second, Japan has achieved its remarkable success despite the fact that it is one of the most oil dependent of the summit nations. It has also achieved its success despite the fact that, with the exception of Italy, it has had the biggest government deficit.

Two features of macroeconomic policy in Japan seem to differ from those in the other countries and, while it cannot be stated categorically that they are the source of Japan's success, there must at least be a *prima facie* case in favour of that conclusion. First and significantly, Japan's monetary policy has been firmer, steadier and more predictable than those of the other nations (with the possible exception of West Germany). Related to this, it is perhaps not insignificant that Japan has controlled and has achieved reduced and steady growth rates of a fairly broad (but not too broad) monetary aggregate. Second, Japan's government sector spends a dramatically lower fraction of Gross National Product than do any of the other government sectors. These seem to be the lessons to be derived from the last six years' experience.

Policy choices

The current policy choices are often posed as being either reflating demand to achieve reduced unemployment and faster output growth or staying with policies that gradually squeeze out inflation. It is already apparent from the analysis above that this is not an effective choice at all. Policies seeking to stimulate demand, and which thereby generate more inflation, do not appear to have much likelihood of producing *sustained* real output growth. Rather, the policy of continuing to squeeze down on the inflation rate with the objective of nearly complete elimination seems to carry no cruel dilemma. Real output growth potential would likely be enhanced rather than damaged by such a policy. There are many reasons both *a priori* and in terms of solid empirical evidence pointing in this direction.

The key question seems not to be whether policies should continue to be disinflationary or whether they should be stimulatory; rather, the question becomes how is it possible to pursue disinflationary policies? Although Japanese policy has been successful, it is not obvious from that success how other nations might pursue firmer monetary policies. In principle, all the nations of the summit group have been pursuing such policies since the middle 1970s. The trouble is they have not succeeded, for various reasons that are not easy to pin down. The key problem is to find a way to get central banks to precommit themselves to steady and gradually lowered money supply growth targets and then to deliver on those targets. Further, it does not seem to be enough, as the Canadians and Americans have done, to achieve lower growth rates of narrow monetary aggregates simply by raising short-term interest rates. That has the effect of raising the velocity of circulation and leaving the overall growth rate of nominal demand largely unaffected. Perhaps the best use to which the summit can be put is for the Western leaders to spend most of their time interrogating the prime minister of Japan on precisely how the Japanese pursue macroeconomic policies with such vigour, single-mindedness and good effect.

It is hard to sustain the myth often perpetrated by politicians and professional economists alike that there is a cruel trade-off between inflation and real economic growth or between inflation and unemployment.

Behind Japan's Economic Success

Workers form quality control circles to ensure total quality control, improve product quality and increase worker morale

by Norikazu Sato

One of the least recognized factors in the strength and stability of the Japanese economy is the concept of "total quality control."

While the idea of quality control itself is not new, its Japanese application is. Transplanted from North America to Japan, it has been developed into a concept known as total quality control, where workers participate directly in the quality control process, as opposed to having only a single, sometimes small, quality control department.

Quality control "circles" are established from the rank and file and middle management. Workers and management might come from several divisions within a firm, such as research and development, design and planning, production, sales and consumer service or an auxiliary department.

Management creates the climate whereby workers interested in quality control will organize a circle and persuade other workers to participate. This activity is treated as an extracurricular activity and could be compared to the voluntary organizing efforts that take place in North America when employees organize a company baseball league.

A circle first studies statistical quality control methods and becomes knowledgeable in the detection of chance and discernible errors. It then chooses a particular theme of quality control — such as improvement of quality, better consumer service, or increased productivity in both the factory and office. Now the circle is ready to pursue its aspect of quality control.

A common sequence of steps taken usually includes:

- determination of quality standards;
- examination of actual quality of current work;
- recording of errors in comparison to standards;
- correction of defective work; and
- analysis and improvement of quality.

Through periodic meetings the circle reports to other workers and management on different techniques for meeting the group's quality control objectives. Widespread participation is encouraged and input is accepted from other workers and management. These meetings also serve to broaden participation in the circle itself.

The method of statistical quality control was first introduced in Japan in 1949 under the leadership of an American expert on productivity and quality control, Dr. Edward Deming. The Japan Productivity Center (Nihon Seisansei Honbu) and the Union of Japanese Scientists and Engineers (Nihon Kagaku Gijutsu Renmi) subsequently promoted the spread of quality control circles and educated their members. Quality control circles began in several firms in 1962. The number of such circles registered by the Union of Japanese Scientists and Engineers was 10,000 in 1965, growing to 110,000 by 1980.

The Japanese total quality control system concerns itself not only with the traditional areas of production of high quality goods and services but also with research into areas such as consumer preference, productivity, and consumer service. The theory of quality control is one that applies to all operations to improve organically the quality of products, services and productivity. Hence, the Japanese concept of "total quality control" emerged.

Thus far, very little has been said of management's role in the quality control process. While the activity of quality control circles is voluntary, it is linked very closely with management's strategic planning process. Because the final goal of quality control circles is the prosperity of the firm, their objective is consistent with that of management. Management examines the quality control techniques and ideas put forward by the worker circles with one eye to their cost and another to their potential payoff. Any ideas considered to have merit are instituted by management.

In response to a strong competitive market, Japanese management has invested vigorously to improve quality control, introducing new and more powerful plant and equipment and computers.

In many cases workers have been replaced with industrial robots. Japanese manufacturers use ten times as many industrial robots as do U.S. manufacturers.[1] Such investments free Japanese workers from increasingly routine manual work, permitting them to move to more highly skilled and challenging work.

This new equipment enables workers not only to produce the same quality of goods and services but also to control the quality of products more efficiently. Conse-

The author is a visiting Research Associate from the Japanese Economic Research Center in Japan.

[1] "Why Quality and Productivity Differ Between Japan and the U.S.A.," *Oriental Economist*, August 23, 1980, p. 38.

quently, there has been a steady decline in the ratio of substandard products to total output. For example, the ratio of substandard integrated circuits made in Japan is one fifth that of U.S. producers.

The results of these investments in total quality control have been higher yields, improved productivity, lower costs, higher profits and an even stronger competitive market. Furthermore, with workers encouraged to participate in the circles for quality control, morale and motivation have improved substantially.

It can be argued the fundamental element behind Japan's economic success has been its commitment to total quality control. This commitment was a major factor behind Japan's ability to adjust to the uncertain economic environment of the 1970s, as illustrated by Japan's response to the first oil crisis of 1973. The economic impact of the crisis demoralized workers. However, total quality control has helped to reverse that trend. It has strengthened their will to work as well as the quality of their work.

After 1973 Japan's international competitiveness increased, resulting in an appreciation of the yen, which in turn restricted import prices for oil and raw materials and helped to stabilize domestic price increases. An enhanced international competitive position made possible a less restrictive monetary policy, so promoting increased domestic investment. As a result of these and other factors real GNP growth in Japan has outpaced that of other industrialized countries by about 2 percentage points in recent years (see Table).

Japan's success with total quality control rests chiefly on the worker's attitude toward the quality control circles and the management's attitude toward the investment for quality control.

Why do more and more Japanese workers participate in these circles? To answer this question, a bit of background is needed. The Japanese people share the same language, history and culture, with common links to the past, present and future. This promotes a feeling of oneness. In the factory the manager wears the same type of suit as the worker. The two often work side by side, sometimes operating the same machine and often lunching together in the same lunchroom.

All workers are viewed as being of equal value. Such an idea of equality promotes identification with and group loyalty to the company. This loyalty is one of the reasons why employees want to further the success of the firm and their own group by participating in total quality control.

Furthermore, Japan has traditionally had a system of life employment, which avoids the frustrations that develop in the layoff-recall system. Workers have the feeling of oneness and security with the company, which also promotes loyalty.

While formal profit sharing is not widespread, workers do reap some of the financial benefits of total quality control in increased standards of living. They also share in the pride of a strong, growing company. For the abovementioned reasons, more and more Japanese workers are participating in quality control circles and share high morale.

Managers in all industrialized countries have seen the rewards of the total quality control process over the years in productivity, costs, sales growth, and a strong overall economy. Therefore total quality control is very highly valued in corporate strategic plans.

But Japanese managers invest much more strongly in quality control than do Western managers. Why? In the short run, the investment may not produce business income. Nevertheless, Japan's management believes it pays off in long-run total profit maximization. In more industrialized countries, managers attempt to maximize return on investment on an on-going basis. Therefore managers typically do not invest in new, powerful plant and equipment unless they produce business revenue immediately upon going into production.

The different attitude toward investment in Japan reflects a different concept of competition. Japan's industrial society places a high degree of emphasis on competition among groups and organizations. The Japanese want to develop the group for its own survival and therefore work hard as a body. This leads to intense competition among business organizations but not among persons in Japan. In contrast, most Western nations emphasize competition at the level of individuals.

This strong group business competition originates in the traditional Japanese family system. All family members worked for the family under direction of the family head. In this system, an individual's ability or worth was not judged primarily on his individual accumulated wealth but on his contribution to the development of the group. As a result, every Japanese person considers the group's interest and development first. In order to survive, all groups compete with each other. The corporate group in modern times has taken on many aspects of the family group. In such a strong competitive industrial society, Japanese management's attitude toward investment for quality control becomes stronger than does Western management's.

Management, greatly supported and reinforced by the workers, has created a viable total quality control system in Japan. The tremendous impact of Japanese exports on foreign markets further bears out the effectiveness of a system involving all levels of personnel in each industry. Total quality control will continue to have a top priority in Japanese industrial strategy in future. The Japanese are not likely to change a winning game.

Growth of Real GNP at Market Prices
(Percentage changes)

Country	1970–76	1977	1978	1979	1980	1981
United States	2.9	5.1	4.4	2.3	−0.75	0.75
Japan	5.2	5.4	5.9	5.9	5	3.75
Germany	2.6	3.0	3.3	4.5	1.75	−0.25
France	4.2	2.8	3.6	3.3	1.75	1
United Kingdom	2.3	1.0	3.6	1.5	−2.25	−2
Italy	3.0	1.9	2.6	5.0	3.75	−1
Canada	5.1	2.4	3.6	2.8	−0.5	1.25
Total of above countries	3.4	4.0	4.2	3.4	1	1
Total OECD*	3.4	3.7	3.9	3.3	1	1

*Organization of Economic Cooperation and Development
Source: *OECD Economic Outlook*, December 28,1980.

Why Can't We Do What Japan Does?

Japan's unique society and 30 years' lead time have produced seemingly unmatchable productivity and quality control

by J.E. Struthers

Japan's production and exporting successes seem almost unbeatable. The world looks with admiration and envy on the industrial achievements of that country, and many key planners in North American and European industries are studying the elements of Success Japan with a view to transplanting, buying, borrowing or recreating those elements.

Along with remarkable production and exporting achievements, Japan also now enjoys the PR "image" of success. The Japan image, like a coin, has two sides. Opposite the glittering success side is a picture that hints from time to time of technical bankruptcy. Japan fell into deep economic trouble, for example, as a result of the world's oil crisis of 1973–74 and recovered. Again, due to the Iranian situation, which started two years ago, expensive oil has put Japan's balance of payments into deficit.

Having almost no indigenous raw materials, Japan needs to import 90 per cent of its energy, three quarters of which is oil, and therefore it pays an enormous price for its successes. Its trade deficit in 1979 was almost $2.5 billion, and the deficit continued into 1980.

The grimmer side of the coin is pictured here merely to put the success side into perspective, so that minds this side of the Pacific, filled with the excess of wonderment about the production and exporting "magic" of Japan, will not be overcome by feelings of envy, awe, jealousy or resentment. (Can it be imagined what would happen to the lot of Canadians if Japan instantly fell off the face of the earth — if our $2 billion trade surplus with Japan instantly disappeared?)

The author is Vice-President, Canada-Japan Trade Council.

Meanwhile, in both the private and public sectors of Canadian life, business minds have been concentrating on the Japan success story. In recent months there has been a starburst of conferences, symposia, panel discussions, public pronouncements and media comment on the success side of Japan and what at times seems like a scavenger hunt for the secrets of the success.

Basic Statistics — 1980

	Canada	Japan
Area	3,851,809 sq. mi.	143,750 sq. mi.
Population	23.9 million	115.9 million
GNP	$288.1 billion	$1.3 trillion
GNP per capita	$12,409	$11,217
Total imports	$92.4 billion	$174.5 billion
Total exports	$89.6 billion	$160.2 billion
Merchandise imports from Japan	$2.8 billion	
Merchandise exports to Japan	$ 4.4 billion	

Note: Japanese figures are for the 1980 fiscal year and were converted into Canadian dollars by The Conference Board of Canada at the rate of $1=183.4 yen.

Sources: for Canada, *Canadian Statistical Review*, February 1981; for Japan, Japan Trade Centre, Toronto.

Interpretations of ruminations by business and industry, which do at times border on petulance, are expressed occasionally. For example, one news report paraphrased parts of an address by the president of General Motors of Canada Ltd. and headlined him as being "critical of Japan trade policies." The president was said to have been critical of the Japanese automotive industries for concentrating production at home. "By simply exporting and exporting, Japanese manufacturers do not contribute to the industrial development of other countries, only to the service industry that sells and services their products," the news report of his address stated.[1] This generalization, of course, is not supportable. The Japanese are contributing to the development of industries in many countries.

Besides the direct input of Japanese plant capital investment to other countries and the purchase of products from other countries, there is yet an indirect contribution being made by the Japanese, most noticeable in the United States recently and now in Canada. It is the introduction of their so-called secrets of success into the North American manufacturing process.

We on this side of the Pacific are just beginning to do what the Japanese have been doing for some time, and we will be hearing more about intelligent robots, numerical control equipment, quality control circles among employees (see article, page 22) and computer-controlled production. This sounds like new industrial initiative motivated by the example of Japan's success. The Japanese, however, are consistent in acknowledging that they learned much, especially about productivity and quality control, from American experts who visited their country in the 1950s. They took the knowledge and technological developments of the world's industrial leader and applied them to the needs of Japan. In other words, they took U.S. industrial know-how and improved on it at a time when people began to build "a pile of rubble into a nation with the second-largest gross national product in the free world," as a leading Japanese banker has expressed it. Some North Americans today say that "Yankee" ingenuity crossed the Pacific 35 years ago and has now come back again with quite a bit of Japanese content added.

While Japan's economy was growing, the North American "plant" and a lot of other elements of its industrial capacity were allowed to fall into obsolescence, and the results are well known — loss of markets for North American products and unemployment being among them.

. . . a system of industrial policy-setting . . . binds Japanese labour, management and government leaders more closely than in most developed countries.

There are, of course, many elements that make up the production and exporting success story of Japan. They are bound up in a system of industrial policy-setting not familiar to many Westerners. The system binds Japanese labour, management and government leaders more closely than in most developed countries.

A viewpoint that has been expressed by leaders in the labour union sector of Japanese society may sound impressively responsible to Japan's North American critics, including the president of G.M. Canada Ltd. An example of the kind of public statement by labour that also makes some North Americans and Europeans scratch their heads a bit was demonstrated not long ago by Ichiro Shioji, president of the 570,000-member Confederation of Japan Automobile Workers.

Shioji had proposed creation of a tripartite committee of labour, industry and government leaders in Japan to take steps to counter a rising protectionist mood in the U.S., Britain, West Germany and other countries where domestic auto sales have slumped. It was not the content of his proposal that made the example noteworthy so much as the words he used in association with it.

If Japan continues to export and unemployment results in the other country, Japan is obliged to consider that unemployment as its own problem.

In an interview, Shioji did blame low sales and high unemployment in the U.S. auto industry on "the failure of the American auto industry in its long-term policy-making," but added, "This does not justify the prevailing attitude of Japanese auto makers to exploit this opportunity to sell more cars. I believe this attitude has to be changed."[2]

Asked if he believed Japan's auto makers should manufacture overseas even if it meant a loss of Japanese jobs, Shioji replied, "That's right. I do not go along with the idea that as long as Japan enjoys prosperity and no unemployment we should tolerate unemployment in other countries. If Japan continues to export and unemployment results in the other country, Japan is obliged to consider that unemployment as its own problem."

Today it would seem we have much to learn from Japan. In North America quality control campaigns within industry seem to have been one-shot events, as pointed out by Joji Arai, who heads the Japan Productivity Center in Washington, when he spoke at a quality control seminar in Toronto early last November. Quality control (QC) must be a continuing process, but it won't work unless the chief executive officer of the company is part of it, he told the seminar jointly sponsored by the Ontario Ministry of Industry and Tourism, the Metro Toronto Board of Trade and the Japan Trade Centre. Unfortunately, few, if any, chief executive officers of manufacturing companies were present. An employee of a large Canadian manufacturing company in attendance commented after the seminar, "I am responsible for quality control at our plant, but I'm really not the one to be here; I report to the personnel manager."

There is a colloquial saying in Japan that seems to have a North American slang to it: "Don't work harder; work smarter." This philosophy pervades blue-collar workers as much as any other group, and in their circles they accept the idea that if they increase productivity and quality control "tomorrow will be better" for them and everybody in Japan. Compensation for this extra effort is not their motivation. Arai cautions that this kind of blue-collar worker philosophy cannot be transplanted easily to North America. He points to an important qualifying factor: a

[1] "GM president is critical of Japan trade policies," *The Globe and Mail*, December 5, 1980.

[2] "Automobile union head suggests Japan curb vehicle exports," *St. Catherines Standard*, September 15, 1980.

Japanese worker, generally speaking, is guaranteed employment in his company for life.

Arai is also frank about Japan's extra capacity to invest in new plant and equipment, which, he explains, is partly because it does not pour as much money into defence as the U.S. finds it is obligated to do. The widespread introduction of exotic tools of production, such as industrial robots and numerical control equipment, further advances Japan's rate of quality output.

Other Japanese business experts elaborate further on the unique factors leading to Japan's economic success. "The key element in our economic growth is the Japanese society itself," says Kyonosuke Ibe, chairman of one of Japan's largest banks, Sumitomo.

> Japan has been shaped by history and geography to be austere and adaptable. In a country where only 15 per cent of the land area is arable and a large population must be supplied, austerity developed long ago from an economic necessity into a way of life and a form of art. Our paintings and sculpture, our architecture and our gardens have been designed on the premise that 'less is more' because less is all there is.
>
> When Japan's industrial revolution, the Meiji Restoration, took place in 1868 the austere character of the society was already well-defined within the feudal system. Change came so quickly that the feudal ties of loyalty were not eroded but were transferred ... the newly industrialized worker gave his loyalty to the employing corporation. In return, the corporation gave the worker the assurance of lifetime employment.[3]

Ibe credits two national characteristics of Japan, namely austerity and total loyalty to the company, as having been the basis of the spectacular rise in the economy. They have provided a highly motivated, team-spirited work force that identifies with the fortunes of the company.

Ibe challenges a Western perception of the Japanese as being obedient "workaholics" by saying, "I would be happier if I could also say that we don't have any bumbling bureaucrats, mediocre managers, or inept workers, as other countries do." But a co-operative labour-management relationship there is:

> Memories are still fresh from the years following 1945 when management and labour together picked up the pieces of what had been industrial Japan and a dedicated work force kept production moving every minute to earn enough income for the burden of interest payments and high depreciation costs. The work force came through and developed a tradition of participation as thinking human beings rather than as cogs in production machinery.[4]

Can Canada learn much from Japan to achieve our own economic successes? Yes, but the foregoing indicates that not all elements of Japan's accomplishments are transplantable to Western industrial societies and few can be adopted easily.

One example of a fairly successful transplant is found in Wales, where a Sony television manufacturing plant has an impressive production line and a quality control system functioning along Japanese lines. The general manager, Tetsuo Tokita, who earlier worked on the development of the famous Trinitron television picture tube, is responsible for transforming in seven years an empty piece of property in economically depressed South Wales into a $250 million business employing 900 people. For this Tokita was made an honourary Officer of the British Empire, the first Japanese to ever have been so decorated.

Certain deep-rooted Western perceptions of the Japanese take a long time to fade, however. The uninformed hold onto the notion of a low-paid, subservient work force in that country which competes with our industries. It doesn't take much study, however, to learn that the opposite is true. The well-trained, thoughtful, well-educated management-worker teams of Japanese industry today are moving rapidly into an era of industrial automation. They have a view of technology that has two positive premises: that automation makes their industries more competitive, and that humans should not be expected to be cogs. "Work smarter, not harder" is the operative phrase, and there is agreement that the new products of research and development, such as robots, can assume more of the "cog" role.

While Canada lacks a robot industry as such, several firms have developed robot components and related remote-control equipment. Diffracto Ltd., in Windsor, Ontario, is producing a vision system that enables automotive robots to spot the difference between various car models, thus enabling the robots to select which programmed routine to perform. Jarvis Clark Co., a North Bay mining equipment manufacturer, worked with Falconbridge Mines to develop the Farco Scoop, a remote-control ore-loading machine. The new Windsor transmission plant of GM of Canada Ltd. is to install 22 miles of new assembly lines that will use many elements of automation, including major transfer equipment manned by robots.

Productivity, quality control and new automation technology are key elements needed to aid economic recovery of sick industries, but they certainly do not create instant cures for unemployment and accompanying social ills; in the interim, they may actually make them worse.

Look across the other ocean to the United Kingdom's gigantic British Steel Corporation. It is undergoing massive surgery, in the hope that it can be made efficient and productive again. British Steel's new chairman and "surgeon," Ian MacGregor, makes wistful references from time to time about a Japanese steel mill where "you could fire a gun through the middle of their steelworks and the chances of hitting anyone would be virtually nil; but they still produce a lot of steel."[5] The implication is clear but, unfortunately, MacGregor says, the work force of British Steel must be cut by 22,000 in the next year in order to first reduce its inefficient productive capacity, introduce efficiency and start trying to regain lost markets.

The socio-economic dilemma exemplified by the British Steel situation could be part of an answer to the broad, general question, "Why can't we do what Japan does?" The truth is we simply cannot do, in short-term programs, what Japan has done during the long evolutionary recovery from its "pile of rubble" condition of 1945. We also cannot make Western society Japanese. Nonetheless, we can look to the Japan example as a guide to the resetting of some standards for our own future achievements.

[3] "It took the Japanese to build Japan," *Business Week*, October 6, 1980, p. 17.
[4] *Ibid.*

[5] "MacGregor takes the scalpel to British Steel," *World Business Weekly*, January 12, 1981, p. 10.

The High Cost of Indecision

A stable industrial base cannot be built by protecting industries that are not adapting to a changing environment

by Robert Angus Bandeen

Canada faces difficult decisions to revitalize its economy. In the past, all too often our responses to economic problems have been shortsighted. We haven't always had the courage to make the decisions that would guarantee our long-term prosperity as a nation. Instead, we've opted for short-term bail-outs or politically popular stopgap measures.

Yet economic prosperity — not only of individuals, but also of the country as a whole — depends on our ability to take up the challenge of making the hard, long-term decisions necessary to renew that prosperity. Only with a healthy economy and productive industries can we achieve the other social objectives we value. The decisions we make in each of our industries, taken together, establish the direction our economy will take. It is essential, therefore, that we carefully examine the impact of today's decisions on tomorrow's prospects.

When a country is in a period of rapid expansion, perhaps it can afford the luxury of propping up a few troubled businesses. But when it is facing a period of slower growth, it must use public and private investment dollars more wisely.

Whereas economic issues were once of concern only to businessmen, government policy-makers and academics, now they interest a wider audience; they are front-page news. Taxpayer unrest has put governments on notice that public funds have to be targeted to the most important social needs. There has been a further shift in public concern with slow growth overtaking inflation as a subject of widespread public attention.

We know that the trade-offs between short-term and long-term considerations will be difficult to make. What is lacking is a framework in which these trade-offs can be assessed. As a country, we are making many short-term decisions without sufficient consideration to the impact they will have on our long-term prosperity. Such stopgap measures could institutionalize the country's industrial weaknesses.

We have been assisting and protecting industries that have not adapted to a changing environment. This may address an immediate problem of regional job losses but may also have the long-term effect of encouraging the existence of uncompetitive and ultimately non-viable industries. A stable industrial base cannot be built through propping up or bailing out troubled industry.

At the same time, there are strong pressures for more severe constraints on those industries that are trying to adapt to economic and technological change. For example, a business corporation may respond to uncertain markets by cutting back on inventories or production, perhaps even closing some plants or retail outlets. Or it may attempt to control costs or improve productivity through introducing new labour-saving technology.

For the corporation such steps may seem to be a reasonable and necessary response to its economic environment. But the social consequence is that individuals and communities bear a greater burden of the costs of economic insecurity. Business is increasingly being asked to accept a larger share of these costs. However, this imposes a heavy load on businessmen by limiting our ability to respond effectively to market pressures.

National policies that capitalize on the strengths and address the weaknesses of the country's economy are badly needed. We cannot afford to let shortsighted and parochial interests inhibit our ability to build on our strengths. Business must be allowed to respond to economic pressures and

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to adopt new approaches that will enhance future productivity. And our social institutions must ensure that people are more able to respond to rapid shifts in their economic environment.

Because our individual concerns do not exist in isolation, a solution for one group's or region's concerns may often create a new problem for someone else. Grants to manufacturers in one province, for example, are met by protests from manufacturers in another.

Businessmen are often caught in the squeeze between two forces. Not only do they have to cope with an unstable economy, volatile markets, and increasing costs, but they often face political uncertainty as competing interests try to sort out their priorities. At the same time, individuals must deal with job and income insecurity and the associated problems of community instability.

The challenges facing today's politicians are also difficult. Governments must steer a tight course through a series of complicated and often paradoxical policy problems: slow growth coupled with inflation; declining growth rates in Canada's industrial heartland and runaway growth in other regions; the co-existence of high unemployment rates and critical shortages of skilled labour.

The slow, uneven growth we are now experiencing has heightened our awareness of Canada's economic vulnerabilities. We remain a favoured nation, rich in natural and human resources. However, too many of our economic indicators suggest the symptoms of long-standing economic problems that we have not addressed adequately.

In this context, there are two concerns I feel we must address:

- First, in the adjustment process that we face, we must determine how the social costs of economic insecurity and change are to be distributed. Employees cannot be asked to carry these costs by themselves, but the effects of assigning too much of them to industry must also be recognized.

- Second, we are now faced with critical shortages of skilled labour at the same time as we confront high unemployment rates. We must question our current approaches to skills training to see whether they are adequate.

Canadians are asking themselves why, when there are so many jobs open, we don't have a systematic way to retrain people. This issue is also contributing to interregional political tension. For example, while Albertans are concerned about meeting labour demands, Ontarians are worried about their inability to provide enough jobs.

I believe that a significant step for the future is to enrich the skill levels and thus the versatility and adaptability of the Canadian labour force and Canadian industry.

The relationship between a business and the community in which it operates is a two-way affair. In prosperous times it is a relationship that is mutually beneficial. The community supplies the industrial and social infrastructure; business supplies direct employment and generates additional economic activity.

The interdependence of a business and its local community shows up most strongly, however, in times of slow growth — especially when business is forced to cut back or make other decisions that affect job levels.

Job losses reduce community spending power, decreasing the demand for local suppliers and local service and retail industries. They cut municipal tax revenue and increase social welfare costs. These effects are most acute — for both a business and the surrounding community — in single-industry towns and in regions with a sluggish economy.

Given this mutual dependence, how should we distribute the social costs of the current economic conditions? What is the appropriate balance between letting business adapt to its circumstances and requiring it to buffer the effect of these changes on employees and local communities?

Enhancing competitiveness, keeping businesses alive, may sometimes cost jobs.

Determining this balance involves making very difficult trade-offs. Unemployment already stands at unacceptably high levels; yet it is clearly in the national interest for Canadian industries to remain productive and competitive over the long haul. Enhancing competitiveness, keeping businesses alive, may sometimes cost jobs.

We need to be more realistic, I think, in weighing the pressures on individuals and communities against those inhibiting business, in order to determine an equitable balance of the costs of change.

People in the local community feel that their contribution to business prosperity during the good years entitles them to considerate treatment when lean times strike. Unions and community spokesmen sometimes argue that business is now passing on too much of the cost of the current economic uncertainty.

Business is being pressed not to act too hastily in response to fluctuations in the business cycle. When layoffs become necessary, national and multinational corporations are under strong pressures to ensure that one region or country is not disproportionately affected.

Business is also being asked to publicly explain layoff decisions, to give longer notice of large-scale layoffs, to provide severance pay or early retirement and pension options or all, and to contribute toward the retraining and relocation of displaced employees. The cost of such measures is now widely seen as one that business itself should bear.

The *Toronto Star*, for example, stated that these costs, "like the cost of meeting safety or anti-pollution standards, should be accepted as part of the cost of doing business in Ontario."

As businessmen, we have a responsibility to employees and the communities in which we operate. Our responsibility is to help them adjust to economic forces, even as we ourselves are trying to adjust.

At CN, when we were faced with the need to change our Express services, we sat down with the union leadership to work out a plan that would ensure a maximum of security for the many employees who have helped to build the company over the years. Retraining was a part of the layoff package. CN Express employees are being retrained — even across division and union lines — for any CN position for which they meet basic qualifications. In this way, CN is able to adapt to market conditions while fulfilling its social responsibilities to its employees.

Most businessmen do not dispute that individuals and communities must be protected to the greatest possible extent. Yet industry will not be able to sustain its contribution to the Canadian economy if it does not have enough freedom to change and adapt to the market pressures it faces.

If Canada is to have a healthier, more stable economy, there must be limits to the requirements employees and communities place on employers.

Industry's share of the social costs of adaptation must not be raised to the point that viability is jeopardized. For example, the community obligations of a business must not impose a burden that will discourage investment in just those locales that need new jobs from stronger, more efficient industries.

The trade-off between maintaining jobs in the short term and achieving a healthy economy and jobs — albeit different jobs — in the long term is becoming more clear to the public and to politicians. This is evident in some reluctance on the part of government to legislate stringent layoff controls that may preclude business adaptation or discourage future investment.

It is also evident in the increasing critical discussions of the consequences of subsidizing businesses that have consistently low earnings and poor markets. Research tells us that such shortsighted measures are no longer seen as acceptable to the general public. A research report on economic trends finds that:

> Aid to troubled industry is not an acceptable long-term solution to industrial decline in the eyes of most Canadians, especially if it is not tied to clear and visible performance criteria. Sporadic, last-minute assistance to first one industry and then another is creating concerns that economic policy is a matter of plugging holes in the dike rather than of creating a viable industrial base.[1]

I believe that the challenge is to ensure that resources are allocated to improving Canadian production methods, upgrading the skills of the work force and creating promising new industrial activity. While we must be aware of and responsive to the social costs of changes required to ensure a healthy business, some of the attempts to stem the tide of change may not only be futile but misdirected. We need to adapt our economy and our work force to the realities of the '80s.

One positive measure that can be taken immediately is to invest in more skills training. As I indicated, Canada now faces the paradox of high unemployment co-existing with severe shortages of skilled labour.

Until recently, we relied too heavily on immigration to provide us with trained and experienced tradesmen, and we have not sufficiently integrated our educational opportunities with our emerging industrial needs. The result is an urgent need for more co-operation among businesses, governments and educational institutions in forecasting and responding to manpower needs.

The consequences of neglecting skills training are becoming evident. Not only are Canadians arriving in the marketplace unprepared for its demands, but the skill profile of the labour force is becoming yet another impediment to the development of Canadian industry.

In the rapidly growing economy of Alberta, the petrochemical, mining and manufacturing industries are already experiencing skill shortages, and the energy boom expected over the next decade is very likely to exacerbate them. The microelectronics and high technology sectors are concerned that the skilled labour shortage they face is pushing an already lagging Canada to the rear of world competition. And, at CN, certain skilled workers, such as heavy-duty mechanics and metal workers, are in short supply.

. . . training must be regarded as a continuous or lifelong process.

Addressing the problem of skill shortages requires a re-evaluation of past approaches and the development of new institutional mechanisms.

First, there must be a change of perspective on industrial training. Rather than a ticket or life pass into the world of work, training must be regarded as a continuous or lifelong process. Individuals can no longer expect that one business or one skill can provide them with lifetime security.

Second, there must be more joint action. Industry, educational institutions, governments and unions must work together in forecasting manpower needs, designing ways to meet them and bearing the costs. This is becoming increasingly important as the pace of change in the nature of work increases and as the demographic profile of the labour force shifts toward older age groups.

Finally, we need to provide more on-the-job training. There is a pressing need for industry to recognize that instituting or expanding training programs is a valuable investment. As T. Philip Adams put it, industry must "recognize that training employees is not only a cost of doing business, but that training is good business."[2]

CN has already made a major commitment of resources to training. We are a labour-intensive organization in a highly competitive environment. The technology involved in rail transport is becoming increasingly sophisticated and is still evolving rapidly.

At CN's transportation training centre in Gimli, Manitoba, we have developed programs to meet these needs, and their value has been demonstrated in the higher productivity and greater reliability achieved. Further, formal training programs have enabled management to gain greater control over operations and have facilitated the introduction of new methods and techniques.

The expansion of well-targeted training programs is a positive step that business can and must take immediately. Canada's work force must become more skilled for the country to meet the upcoming challenges. A more skilled and adaptable work force is an invaluable asset to the growth sectors of the economy, and it will also allow industries currently in less fortunate circumstances to make the necessary innovations.

Employees with more skills and training will also, as individuals, be more able to adjust to changing circumstances — and will therefore be less vulnerable to economic uncertainty.

In the absence of a clear delineation of policy directions, more unhappy decisions will be forced upon us by circumstances. Revitalizing the Canadian economy and providing wider opportunities for our citizens involves facing up to some difficult decisions with significant financial and social price tags. These decisions will require courage and determination on the part of politicians and businessmen.

The economic prosperity of Canada and Canadians will be determined, I believe, by our ability to take up the challenge of formulating and acting upon new policies. The cost of indecision will only climb.

[1] *Canadian Trend Report* (Montreal, Trans-Canada Social Policy Research, March 1981).

[2] T. Philip Adams, "Education: a Shared Responsibility," *The Canadian Business Review*, Vol. 7, No. 4, Winter 1980, p. 21.

Female Labour-Force Participation: Putting Modern Trends in Perspective

As more Canadian women decide their place is in the paid labour force, effects on the overall economy must be faced

by Beverly J. Cameron

Large numbers of women leaving the home to join the paid labour force is often treated as a new phenomenon brought on by the Women's Liberation Movement, lower birth rates, changing values in society, or a variety of other causes. But women in the labour force is not a new phenomenon at all.

Women have been in the labour force for centuries. The idea that women should not participate in the paid labour force or that the income of the husband should support the entire family only emerged with industrialization. High rates of female labour-force participation are a very old phenomenon that is simply being renewed in the 1970s and '80s.

Society changes its attitudes and ideals slowly, and some Victorian traditions still influence our attitudes toward women and work. Some husbands still feel threatened by a working wife, and some women still feel it inappropriate to work for pay.

However, by 1981 attitudes have changed enough that almost 50 per cent of Canadian women between the ages of 35 and 64 are in the labour force. The participation rate for all women between the ages of 15 and 64 is only slightly lower, reflecting the effect of child-rearing for those in the 20–34 age group.

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Women choose to participate in or abstain from the labour force for many different reasons but are influenced greatly by the following factors, most of which serve to increase female labour-force participation.

- *Income of the husband or family:* In the past the higher the income of the husband or the rest of the family, the less likely the wife was to work outside the home. Research during the 1970s shows that this income is having a reduced effect on the wife's decision, but what influence there is is still negative.
- *Real wages for women:* While women's real wages (the buying power of money wages) once had a definite positive influence on female labour-force participation, studies in recent years show that this relationship is becoming weaker. It would appear that for women, especially those without young children, real wage rates are having a decreasing influence on the decision to participate in the paid labour force.
- *Education:* Generally, the higher a woman's educational level, the more likely she is to participate, the longer she will stay, and the less time she will take off from the labour force (e.g., for child rearing). Since a higher education often means a more interesting job, better working hours and conditions, more chance for promotion, and higher pay, it is not surprising that more educated women choose to participate in the labour force. Education may also be linked to greater material aspirations that can only be fulfilled when the woman works. Studies predict that as more women finish high school and receive further training, the female labour-force participation rate will continue to rise.
- *Growth of the service sector:* The increase in the size of the service sector (i.e., transportation, communications, trade, finance, community, business, personal services, and public administration) has provided jobs for many women. Service sector jobs often involve secretarial, clerical, or caregiving skills that are typically thought of as "women's work." Many women enter the labour force with only the clerical skills they learned in high school, such as typing, and are easily channelled into traditional secretarial jobs. Today approximately one third of working women perform secretarial or clerical jobs.

  Many service sector jobs allow part-time work and a temporary commitment to the labour force. Both factors may appeal to women with children still at home or to women who do not have long-term career plans. The rapid growth of the service sector has made jobs readily available to women, allow-

Historical Background

The family was the unit of productive activity in England prior to the Industrial Revolution (before about 1750). The husband, wife and children usually worked together as a family unit selling their labour as a group or operating a small shop.

Seventeenth-century farm wives were commonly responsible for the entire dairy operation, which contributed significantly to the family income.

The craftsman's wife helped run the shop and often helped produce the goods that were sold. Usually the wife learned her skills from her husband, who in turn might have apprenticed with another craftsman. If the husband died, it was not unusual for the wife to continue the business on her own.

The farm labourer was often hired with the understanding that his wife would work in the fields at planting and harvest time.

When the United States and Canada were young (and even today in their frontier areas), the family was also the unit of production. Marriage was an economic contract that required the labour of both parties.

When the Industrial Revolution swept over England (1750–1850), the family ceased to work as a unit. Instead factories began to provide individual jobs. Men were the ones trained for skilled work, because their labour-force participation was steady and uninterrupted by child-bearing. Since wives did not work with their husbands, most women had no chance to learn a skill. Without a skill, women were often forced to take the lowest-paid and most tedious jobs industry had to offer. Nevertheless, most wives worked outside the home because of economic necessity.

The same pattern occurred in the United States and Canada. Family members worked separately, and men usually received the job training because they spent more years in the paid labour force. Many women were again left with unskilled, low-paid jobs.

As industrialization progressed, wages and salaries rose, especially in skilled jobs. Many men found that their incomes were sufficient to support their entire families. At the same time, many women discovered that the wages they could earn in industry were not much greater than the cost of household and child-care services they had to purchase while they were working. Many women thus found it made little economic sense to work outside of their homes — so they stayed home.

The trend of women leaving the paid labour force started with upper-middle-class women, since their husbands' incomes were usually greater. Emulation of such activity by the middle and lower classes and generally rising real wages made it possible for more and more women to leave the paid labour force.

Victorian society, and its adherents in the United States and Canada, pictured the ideal female as a frail, delicate creature incapable of hard work. By 1853 "a lady" from the middle and upper classes had evolved into a completely idle ornament.

ed for shorter periods of job search, and provided work in traditionally acceptable "female occupations."

- *Sole support:* The rising rate of marriage breakdowns has put many women in the role of sole income earner for themselves and their families. It has caused others to remain in the labour force for greater financial independence. Married women may want to stay in the labour market to provide themselves with greater financial security. Research shows that divorcees may have accounted for as much as 8 per cent of the total increase in participation between 1971 and 1976.[1]
- *Presence of young children in the home:* The presence of pre-school-age children is one of the strongest deterrents to female labour-force participation. Traditionally participation rates have risen until women reach the 20–24 age group. Then rates fall sharply between 25 and 34, when many women are involved in childbirth and child-rearing activities. After age 35 participation rates increase again and peak between the ages of 40 and 55.

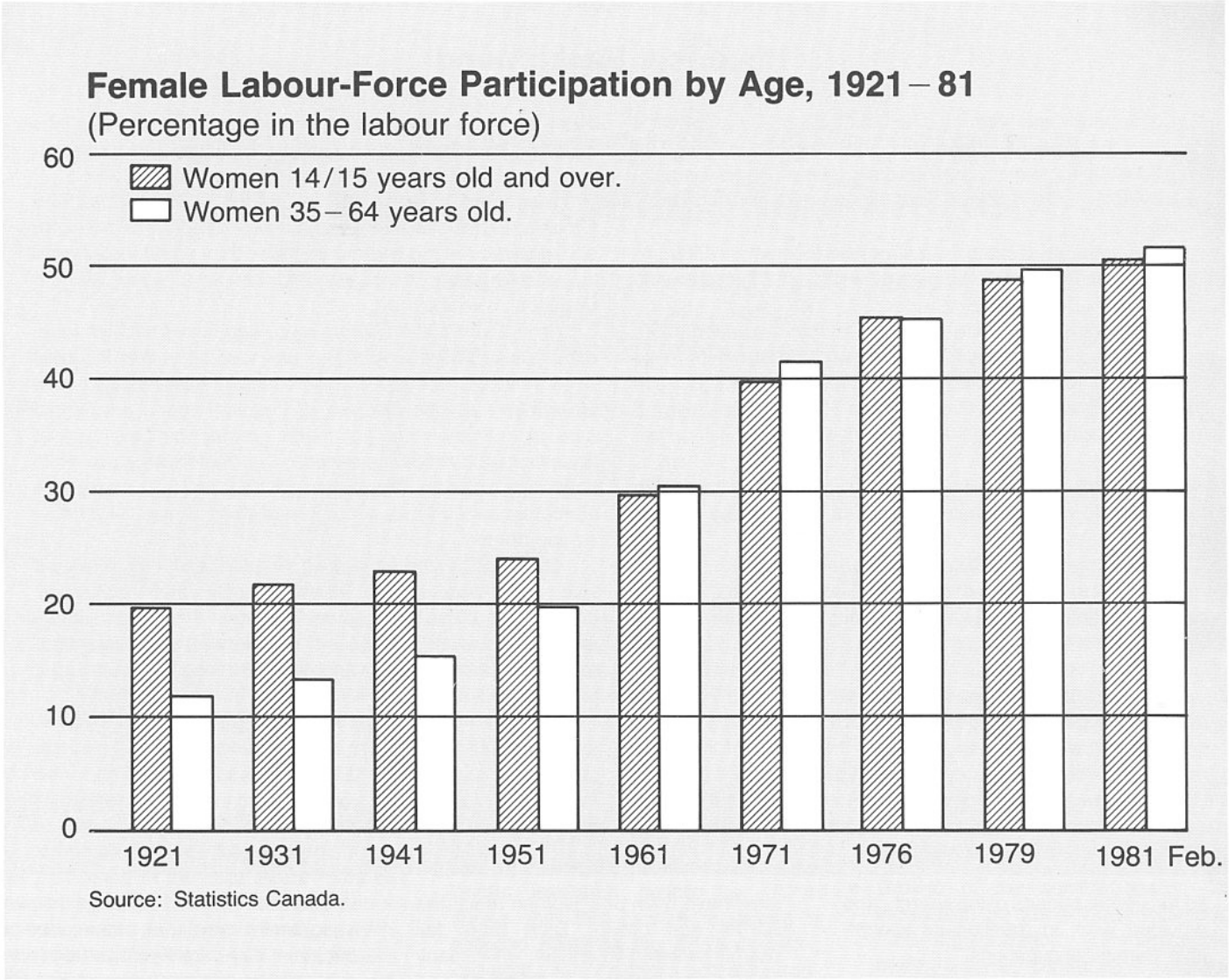
. . . women born more recently . . . are starting to follow the traditional male labour-force participation patterns.

However, women born more recently, between 1941 and 1950, are starting to follow the traditional male labour-force participation patterns. Participation rates have increased for these women between the ages of 15 and 34. This reversal of the traditional female participation rate pattern is also taking place in the United States and two Scandinavian countries.

Why is this? Possibly because the average family size has decreased or because day-care facilities are more available to women. Also, increased material aspirations for the family may not permit the wife to leave the labour force for long periods of time.

- *Job experience:* Personal observation of the participation of female acquaintances suggests that those women who originally enter the labour force with the greatest commitment and those who had rewarding and interesting jobs before they were married or had children tend to stay in the labour force longer and tend to have shorter absences. Those women who start their families after five to ten years of labour-force experience also tend to re-enter the labour force sooner. If young women become more committed to the labour force after they finish their training, if they insist on interesting jobs with advancement possibilities, and if they

[1]Department of Finance, Canada, *Participation Rates and Labour Force Growth in Canada* (Ottawa: April 1980), p. 9.



start their families at a later age, then participation rates may increase further.

It is always difficult to predict future labour-force participation rates. Government predictions, taking the first six factors into account, place the growth of female participation at annual averages of 2.3 per cent until 1985 and between 1.1 and 1.6 per cent between 1986 and 2000.[2] The effects of this increase on the rest of the economy will be enormous. The number of available jobs will have to increase if a rise in unemployment for both men and women is to be avoided, demand for child-care and household services will increase rapidly, and the number of two-income families will rise. More women could begin to suffer from work-related "masculine" health problems, such as ulcers and heart attacks. Community colleges and universities should see a rise in female enrolment as women prepare themselves for longer or more serious commitments to the labour force. The list of effects goes on and on. Every sector of the economy must plan for the increasing supply of female workers and the increasing demands for the goods and services their wages will buy.

While projections show an increase in female labour-force participation till the year 2000, they show a marginal decline in male labour-force participation.[3] It is not expected that female participation rates will reach male rates, but it does mean that the labour force will gradually contain a larger percentage of female workers than in the past. Pension and life insurance plans will have to adapt to this change and a larger percentage of the work force will be eligible for maternity leave.

Industrialization may have brought society full circle. Before industrialization it was assumed that women would work to provide some of the family income. Then conditions of industrialization made absence from the paid labour force not only possible but desirable for many women. Today Canadian women are deciding in ever increasing numbers that their place is in the paid labour force as well as in the home.

[2] *Ibid.*, p. 60.

[3] *Ibid.*, p. 60.

Textile Import Policy Options

Permanent import controls on textiles and apparels camouflage the basic problems of a highly protected industry

Richard W. Wright and Ursula Kobel

Canada's import restraint policies have recently been subject to much debate, especially with regard to the highly protected textile and apparel industries.

The textile and apparel industries in Canada currently employ approximately 200,000 people directly and an estimated additional 330,000 indirectly. Shipments from the two industries should exceed $9 billion in 1980, with exports approaching $600 million.[1]

There are manufacturing plants in all provinces, but employment is concentrated in Quebec (60 per cent), Ontario (30 per cent), and Manitoba (4 per cent). Although these two industries account for approximately 11 per cent of all manufacturing employment in Canada as a whole, that figure approaches 22 per cent in the Province of Quebec.[2] The apparel industry is the largest employer of manufacturing manpower in Manitoba, and its importance as an employer there is steadily increasing.[3]

Approximately 75 per cent of textile and apparel industry employment is female. Geographic mobility is very low. A study by the Department of Manpower and Immigration (1970) indicated that employment alternatives for workers from these industries are limited for four principal reasons:

- Average level of education is low.
- Average age is over forty.
- Workers are predominantly female and secondary-wage earners.
- Many workers have limited command of the English language.[4]

In support of the argument of limited mobility, a recent government study of the 1976 closure of Associated Textiles Ltd., of Louiseville, P.Q., a town of 4,000 persons some 18 miles from Trois-Rivières, showed that, of 437 people laid off as a result of the plant closure, 34 accepted early retirement. As of May 1978, 200 former employees were still unemployed, and a survey concluded that 95 per cent were not willing to move even if they were offered suitable employment.[5]

By 1960, it had already been noticed that imports of clothing and cotton textiles were cutting into the domestic market. This problem was exacerbated by the spread of man-made fibre technology to several developing countries at a time when synthetic fibres were not covered under the old GATT- (General Agreement on Tariffs and Trade) sponsored long-term arrangement, and the Canadian manufacturers' share of the Canadian market began to drop.

Originally the bulk of low-cost imports was concentrated in the textile fabric end of the business. While there have always been problems with promotional items such as shirts and jeans, and later sweaters and outerwear, the really serious impact on

[1] Canadian Apparel Manufacturers' Institute, personal interview by author, 1980.
[2] Government of Canada, *The Textile Industry — a Canadian Challenge*, p. 3.
[3] Canadian Apparel Manufactuers' Institute, *Apparel Industry Comments on Liberal Caucus Research Bureau Paper "Special Protection for the Textile and Clothing Industries,"* Ottawa, November 12, 1980, p. 5.

[4] Textile & Clothing Board, *Clothing Inquiry* (Ottawa, 1977), p. VI, 10–12.
[5] Newall (ed.), *Consultative Task Force on Textiles and Clothing* (Montreal, 1978), App. I, p. 19.

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Table 1
Textiles & Apparel Industries: Establishments, Employment & Selling Price, 1970–79

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
No. of establishments										
Textile	1,008	1,003	1,000	999	1,037	1,029	987	944	N/A	N/A
Apparel	2,450	2,417	2,393	2,355	2,408	2,318	2,235	1,660	N/A	N/A
Total	3,458	3,420	3,393	3,354	3,445	3,347	3,222	2,604	N/A	N/A
Employment ('000s)										
Textile	76.7	77.2	83.4	86.1	85.1	79.8	76.1	63.5		
Apparel	117.8	118.5	122.1	124.7	121.4	119.6	119.5	110.5		
Total	194.5	195.7	205.5	210.8	206.5	199.4	195.6	174.0	178.0*	182.0*
Industry selling price (1971 = 100)										
Textile	—	100.0	98.8	108.3	129.5	132.5	142.5	150.4	159.7	180.7
Apparel	96.4	100.0	102.6	110.4	128.6	142.1	154.1	167.4	178.2	196.0
Knitting	98.0	100.0	102.1	108.6	129.9	135.7	143.0	152.0	162.6	177.9
Manufacturing						153.7	161.6	173.7	190.4	217.8

*Estimated.
Source: Statistics Canada.

clothing producers did not come until the early 1970s. By 1976, major retail stores were also firmly entrenched in direct import programs. Many manufacturers complained that department stores were ordering samples of new designs, then having them reproduced in Hong Kong, Taiwan, or other low-cost countries at a fraction of the cost for Canadian distribution. Importers of apparel and textiles were expanding their markets, and 1976 import levels exceeded the record levels of 1975 by almost 50 per cent on a unit volume basis. At the present time about 8 per cent of textile yarn and fabric imports originate in low-cost and state-trading countries.

The Canadian textile and apparel industries are being protected for three basic reasons:

1. *Redistribution of income and maintenance of employment:* It is feared that if the proportion of imports of apparel and textiles are permitted to increase, Canadian production will suffer, leading to plant closures and unemployment. The province hardest hit would be Quebec, where unemployment rates are already excessively high and where additional economic problems would only add fuel to the separatist fire. The lack of geographic mobility of workers in the industry would make relocation and retraining difficult. It is, therefore, less disruptive to support the industry despite the fact that clothing costs will be forced up for Canadians as a whole, rather than support an additional 250,000 to 300,000 persons on unemployment.

Over the six-year period from 1970 to 1976, the number of textile and/or apparel establishments decreased by 236, despite a significant but short-lived upswing in 1974 (Table 1). Over the same period, there was a net increase in employment of 900 persons. The statistics also show, however, a net decrease in employment of 15,200 persons from 1973, the year of peak employment, to 1976, the year of quota implementation. (There was a world shortage of textiles in 1973, and many textile exporters withdrew abruptly, although temporarily, from the Canadian market.)

Table 2 indicates a rising level of imports as a percentage of apparent Canadian market (by value) from 18.2 per cent in 1970 to 25.7 per cent in 1976, while Canadian exports as a percentage of shipments decreased 0.7 per cent from 5.1 per cent to 4.4 per cent over the same period.

2. *Protection of infant industry:* Although the apparel industry in Canada is hardly in its infancy — in the United Nations Conference on Trade and Development (UNCTAD) terminology, it has moved from being "mature" to "senile" — the argument is the same — protect the industry to give it time to establish itself, to make the capital expenditures necessary to make it more productive and hence competitive with developing country imports. This argument does not apply to the *textile* industry, as it is more technologically advanced than the apparel industry and far less labour intensive.

3. *Political objectives:* This rationale includes maintenance of essential industries in case of war, and indeed clothing may be considered essential. It is estimated that currently there is insufficient capacity in Canada to supply the necessary military clothing as well as civilian clothing.

> Consumers living in our hostile climate should be more concerned about Canada's long-term security of supply for clothing. Some 90% of Canada's garment imports come from developing and state trading countries. Production in a number of these countries such as Korea, Hong Kong, China and Taiwan could be disrupted by hostilities — yet we rely on them for over a third of the clothing consumed in Canada.... How many involved in trading with the Republic of Korea were not concerned about continuity when President Park Chung-Hee was assassinated? To what extent is apparel manufacturing dependent on petroleum-based fibre production? If our apparel supply-lines were disrupted, the short-fall in supply could not readily be replaced from existing Canadian capacity overnight — or by imports from other developed countries because they too, rely heavily on these developing countries for their apparel needs.... Sweden let itself become too heavily dependent on clothing imports and found it did not have the ability to clothe its army.

Table 2
Textiles & Apparel Industries: Trade & Market Statistics, 1970–79

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Shipments ($ millions)										
Textiles	1,813	1,977	2,226	2,551	2,878	2,803	3,076			
Apparel	1,652	1,778	1,948	2,159	2,434	2,700	2,977			
Total	3,465	3,755	4,174	4,710	5,312	5,503	6,053	6,404	7,473	8,568
Exports ($ millions)										
Textiles	101	116	120	157	187	140	160			
Apparel	75	83	93	117	125	105	107			
Total	176	199	213	274	312	245	267	320	387	472
Imports ($ millions) F.O.B.										
Textiles	528	613	744	862	1,057	978	1,119			
Apparel	204	238	331	406	512	617	881			
Total	732	851	1,075	1,268	1,569	1,595	2,000	1,973	2,250	2,828
Apparent Canadian market										
Textiles	2,240	2,474	2,850	3,256	3,748	3,641	4,035			
Apparel	1,781	1,932	2,186	2,449	2,821	3,211	3,752			
Total	4,021	4,406	5,036	5,705	6,569	6,852	7,787	8,057	9,336	10,924
Imports as % of ACM										
Textiles	23.6	24.8	26.1	26.5	28.2	26.9	27.7			
Apparel	11.5	12.3	15.1	16.6	18.1	19.2	23.5			
Total	18.2	19.3	21.3	22.2	23.9	23.3	25.7	24.5	24.1	25.9
Exports as % of shipments										
Textiles	5.6	5.9	5.4	6.2	6.5	5.0	5.0			
Apparel	4.5	4.7	4.8	5.4	5.1	3.9	3.6			
Total	5.1	5.3	5.1	5.8	5.9	4.5	4.4	5.0	5.2	5.5

Source: Consultative Task Force on Textiles and Clothing; Statistics Canada.

> They had to invoke the GATT National Security escape clause to re-build their industry . . . .[6]

Canada's import policies on textiles and apparel have evolved through three distinct phases.

Phase I — 1960–75: In the early 1960s some bilateral agreements were negotiated with low-cost suppliers of cotton textile and apparel products, notably Japan, Hong Kong, Taiwan, the People's Republic of China, Macao, Singapore and Malaysia, among others. As man-made fibres were developed and commercially produced, these too were incorporated into the agreements. These bilateral agreements, though, were of little effect and did nothing to guarantee Canadian producers a share of their own market.

It was not until 1969–70 that the Canadian government saw fit to introduce a textile policy, "designed to bring about an orderly rationalization and strengthening of the textile and apparel industries."[7] The policy included:

- formation of a Textile and Clothing Board to hear industry problems and recommend measures of protection from injurious imports;
- special adjustment assistance for workers who had to be phased out; and
- government assistance for productivity improvement centres.[8]

This situation was temporary. When the then Minister of Industry, Trade and Commerce was not re-elected in 1972, the measures weakened; agreements were not respected, some were dropped entirely, and imports increased sharply.

Phase II — 1976–78: With the drastic increase in imports by 1976, Canadian manufacturers were failing fast and stepped up pressure on the government for intervention. Early in November 1976, the Textile and Clothing Board recommended the imposition of global quotas on virtually all categories of apparel products and many textile products. On November 29, 1976, the government promised five years' protection, and the quotas were introduced, limiting imports to 1975 unit volumes.

Global quotas have their advantages to the manufacturers:

- They provide an overall limit on imports rather than restraints on a country-by-country basis. They are administered and allocated in Canada so there is little possibility of overshipment.

[6] Cogit International Corporation, *The Eighties and Beyond* (Ottawa, Cogit International Corp., 1979), p. 209.
[7] *Ibid.*, p. 19.
[8] *Ibid.*, pp. 19–20.

- They do not have the growth and flexibility provisions included in bilateral agreements.
- The government can set aside a reserve to take account of high fashion and special hardship cases. This comes out of the overall limit — ensuring that, at least in some of these cases, quotas are utilized to import products that cannot be or are not made in Canada, thereby reducing the imports of directly competitive products.[9]

Very soon, however, pressure was brought upon the government, principally by the United States, which was worried that the Canadian actions would eventually preclude renewal of the Arrangement Regarding International Trade in Textiles (also known as Multifibre Arrangement, or MFA) (see Appendix), an agreement necessary for their own textile import protection.

Phase III — 1979–81: Late in 1977, the government began negotiations aimed at reaching bilateral agreements with seven nations that together accounted for approximately 85 per cent of Canada's low-cost textile/apparel imports (Hong Kong, Korea, the People's Republic of China, Taiwan, the Philippines, Poland, and Romania). These agreements were based on 1975 levels and were adjusted for the growth that was denied while global quotas were in place. Agreements have been signed with all the above countries as well as "new entrants" — Thailand, Macao, Bulgaria, Hungary, Sri Lanka, and Pakistan. As of the end of 1979, discussions were underway with India and Malaysia.

These agreements are administered by the exporting countries. While the Textile and Clothing Board had recommended that quotas under the bilaterals be allocated in Canada, the government found that they could not negotiate this condition.

> Exporting countries took the position that it was bad enough to have to agree to limit their exports outside the usual terms of GATT without giving the import permit holder buying leverage over exporters in the restricted country.[10]

In addition to this, textiles and apparel from all sources are subject to tariffs of 22 per cent on most items.

Are import policies successful?

It was suggested above that Canada implemented its import policies with respect to apparel and textiles in order to:

- maintain employment levels in the sector;
- allow Canadian manufacturers the time and support needed to make the technological changes necessary to bring their productivity up to competitive levels; and
- maintain sufficient capacity should trade be suspended.

Employment in the sector, which had been decreasing from 1973, reached a low point in 1977 and since then has been increasing at a rate of approximately 2 per cent per annum.[11] However, from the beginning of the fourth quarter of 1979 and through 1980 there has been a steady reduction in activity among Canadian apparel manufacturers, reflecting the impact of the recession. Imports under quota have not declined to the same degree. Canadian manufacturers have borne the brunt of reduced economic activity.

Table 3 shows capital and repair expenditures for the textile and apparel industries. After a low point in 1977, these expenditures (in current dollars) have been increasing year after year. In constant (real) terms, while these expenditures have been increasing slowly over the past three years, they have not yet attained even the lowest levels of capital and repair expenditures evident during the three years prior to the implementation of global quotas. There are, however, prospects for significantly increased capital expenditures in the apparel industry. These new technological advances offer very good prospects for increased productivity and efficiency. The payback periods are longer, but the investments could pay off — given adequate assurances that a market will be there to serve. The Textile and Clothing Board report, as protectionist as it might seem, will probably result in a reduction in the number of firms in the industry. There is a definite trend toward larger firms, which will be the leaders in adopting new technology. Nonetheless, one must face the fact that no matter what technological changes are introduced in the apparel industry, it will be extremely difficult to overcome the wage advantages of developing countries. These countries are using systems eight to ten years behind Canada's, but the wage differentials are so great that it is economical for them to do so.

Productivity, as reflected by the Index of Real Value Added per Man Hour Worked, is shown in Table 4. While productivity increased year after year, the rate of increase in all sectors except knitting and children's clothing was greater in the period 1971–76 than in the period 1976–79, during which the global quotas and bilateral agreements were in place. This also implies that productivity increases at a faster pace when capital expenditures are high.

A problem with the present import policies concerns the less affluent Canadian consumer. Low-cost imports used to provide clothing at an affordable price to these consumers. Quotas and bilateral agreements still permit the import of low-cost clothing into Canada. However, it is only natural that the exporting company/country will maximize its receipts by exporting the top of their line, the highest margin merchandise they produce. The selling price of these products has risen not only with inflation but also with the rapid improvements in styling and quality that come from experience.

One rebuttal supporters of quotas and restraints often use against consumer claims of high costs is that the selling prices of domestically produced goods have increased less quickly than those of imports. One of the reasons is that imported items started from a lower base and quality level. The reduced value of the Canadian dollar, making imports appear more expensive, is another factor that cannot be ignored.

The industry argues that global quotas were beneficial to Canada's industry — they were administered in Canada, they did not provide for annual growth in imports, and they were flexible enough not to withhold imports of items not manufactured in Canada. They were, however, not in effect long enough for the results to be measurable.

On the other hand, they argue, the bilateral agreements are administered in the exporter's country; they provide for an in-

[9] *Ibid.*, pp. 20–21.
[10] *Ibid.*, p. 23.
[11] Textile & Clothing Board, *Textile & Clothing Inquiry* (Ottawa, Textile and Clothing Inquiry, 1980), p. 18.

Table 3
Textiles & Apparel Industries: Capital & Repair Expenditures, 1974–79
(Millions of dollars)

	Clothing			Textiles & knitting mills[2]			Clothing & textiles			
	Capital	Repair	Total	Capital	Repair	Total	Capital	Repair	Total[3]	Total[4]
1974	20.3	7.0	27.3	158.0	64.2	222.2	178.3	71.2	249.5	196.5
1975	23.1	7.7	30.8	174.2	61.6	235.8	197.3	69.3	266.6	185.1
1976	21.8	8.9	30.7	119.3	67.3	186.6	141.1	76.2	217.3	140.2
1977	21.0	8.2	29.2	87.6	68.4	156.0	108.6	76.6	185.2	110.9
1978	26.1	11.2	37.3	106.3	73.2	179.5	132.4	84.4	216.8	120.4
1979[1]	26.6	10.4	37.0	133.2	78.2	211.4	159.8	88.6	248.4	127.4

[1]Preliminary.
[2]Includes knitted garments.
[3]Current dollars.
[4]1971 dollars.
Source: Statistics Canada.

Table 4
Textiles & Apparel Industries: Index of Real Value Added per Man Hour Worked, 1976–79
(1971=100)

	Clothing			Textile industries	Knitting mills	All manufacturing
	Women's	Men's	Children's			
1976	130.3	119.6	114.5	127.3	110.6	118.0
1977	125.4	116.8	114.5	137.3	117.4	123.6
1978	140.0	127.6	127.9	144.0	133.8	128.6
1979	143.8	127.1	151.8	145.6	135.0	128.9
	Compound Annual Growth Rate — in Percentages					
1971–79	4.7	3.0	5.4	4.8	3.8	3.2
1971–76	5.4	3.6	2.8	5.0	2.0	3.4
1976–79	3.3	2.1	9.9	4.6	6.9	3.0

Source: Statistics Canada.

crease in imports annually and, in addition, allow for entry of new exporting countries at levels of one hundred thousand to two hundred thousand units of each category for their initial year, subject to annual increases, thus increasing more quickly the amount of imported clothing and textiles annually. This problem is compounded during recession years. One of the inherent dangers in the quota system is that it can become a floor as well as a ceiling. This is apparent in the manufacturing and import statistics from the fourth quarter 1979 through 1980, where the declining activity of apparel manufacturers has not been matched by a decrease in apparel imports. Another serious problem is the external administration of the agreements, especially in the case of the People's Republic of China. From the start, China did not live up to the recently signed agreement. When this was questioned, pressure from the Canada-China Trade Council and from Canadian exporters led the Canadian government to be more accommodating, permitting up to 50 per cent of the three-year total of merchandise under the original agreement to be shipped in the first year. Imports from China during 1980 and 1981 are supposed to be reduced due to the "front-end loading" in year one (1979), but Canadian manufacturers are skeptical.[12] Korea has also been accused of overshipping its quota limits.

A recent study commissioned by the North-South Institute claims that Canadians paid $467 million more than necessary for clothing in 1979 because of the government's import policies. The accuracy of this study is questionable, considering many of the factors included in the study, such as:[13]

- A cost of $20.7 million attributed to the fact that consumers did not purchase as many garments as they might have at lower prices. (This ignores the usual practice of discounting and clearance of unsold apparel.)
- A cost to the consumer of $92.8 million for tariff revenues to the Canadian government. Presumably elimination of tariff revenue would require increasing other government sources of funds, such as taxes.
- Assumption that other industries are capable of absorbing large numbers of displaced textile/apparel employees, given

[12]Canadian Apparel Manufacturers' Institute, *Apparel Industry Comments ..., op. cit.*, Annex D.
[13]Cogit International, *op. cit.*, pp. 22–23.

the fact that Canada has already some 865,000 persons unemployed.

- Assumption that textile and apparel workers are free to relocate. Those workers who choose to leave the industry after extended layoff (for example, women who choose to remain at home) are dismissed as voluntary withdrawals.

An interesting but seldom explained point on the costs to consumers of import protection is that Canadian consumers' costs of wearing apparel are among the lowest in the world.

Canada has several available options, which cluster into two groups — those involving import restrictions over and above duties, and those that do not.

Options with import restrictions

Return to global quotas: This option would please the Canadian manufacturers and, according to the study by the North-South Institute, would reduce the costs of import restrictions for the consumer. This system has been tried in the past but was discontinued under pressure from the United States.

The United States objected to the global quota, but for political rather than economic reasons. They did not want to risk hampering the MFA renewal and the recent round of GATT negotiations. The United States and Europe are looking at "globalization" as a real option. This may be one of the few ways to look after the aspirations of the poorest countries — by taking entitlements away from the more advanced developing countries, such as Hong Kong, Taiwan and Korea, in order to make room for the Sri Lankas and Bangladeshes and other less industrialized countries, which now are limited to very low levels due to market domination by the large exporting countries that began export programs 15 to 20 years ago.[14]

This type of approach, a global limit for all low-cost imports, leaving developed-country exports free of restraint, could possibly work. While there is a GATT non-discrimination clause, Article II, Part IV of GATT permits discrimination in favour of developing countries; Article 6 of the MFA requires it. What would be necessary for this is a new MFA that differentiates between the powerful non-industrialized countries, such as Hong Kong and Korea, and the real developing countries.

Continue bilateral agreements, with some amendments: For the manufacturer, it is vital that market share not diminish. With the bilateral agreements as they now stand, new exporting countries are granted significant entry levels. These quantities are added onto levels already granted to the other exporting nations in arriving at potential import levels for Canada. This problem could be alleviated if the bilateral agreements provided for a growth in imports lower than the expected growth in Canadian demand for textiles and apparel. When new entrants are granted their quotas, they would not then cut into the Canadian manufacturers' share of the Canadian market.

The problem of providing low-cost imports for low-income families is difficult to resolve. Under the provisions of GATT as they currently stand, a country cannot grant a favoured status to one country over another. If this agreement did not exist, or were some conditions changed, it would be possible to set aside larger portions of imports to new developing country entrants to the market — those that have not yet developed the technology and the expertise to produce higher quality garments and whose costs are low enough to export low-cost, adequate-quality goods. The problem with most developing countries that have been exporting apparel and textiles over a number of years is that they have achieved levels of skill and technology approximating (indeed probably sometimes exceeding) Canada's. They produce high-quality garments, often even "designer" models, and are interested only in exporting the top of their line.

According to some, denomination of quotas by value rather than quantity would alleviate this problem. However, the GATT Textile Surveillance Body will not approve dollar-based quotas, as they do not protect the interests of the developing countries.[15]

A North American free trade zone: This option would involve free trade in apparel and textiles between Canada and the United States but would not rule out import restrictions outside of North America. Co-ordination of Canadian and U.S. import policies would be a necessity, and in all likelihood protection would be increased to U.S. levels, which far exceed Canada's.

Free trade with the U.S. would greatly enlarge Canada's "domestic" market, enabling certain economies of scale, especially through larger runs (primarily in the textile industry), and would reduce raw material costs where cotton yarns and certain man-made fibres not usually manufactured in Canada are concerned.

However, there are risks to consider, as well as potential benefits. These would include the fact that the U.S. market is 12 times larger than Canada's. U.S. production only has to increase 10 per cent to meet Canada's needs. A 10 per cent increase in Canadian production, on the other hand, would be less than 1 per cent of U.S. production. There would have to be a transition period in which Canadian barriers would stay in place or gradually be phased out, say over five years, while U.S. tariffs are reduced immediately, in order to give Canadian manufacturers time to make the adjustments necessary to service the U.S. market — and to prepare for increased competition.

Options without import restrictions

Government subsidy of the industry: At present, the Canadian people are subsidizing the textile and apparel industries through higher prices on wearing apparel. Certain incentive programs and development grants are currently available to the industry. Potentially, the government could subsidize the industries directly, with the aim of maintaining employment and sustaining an essential industry. This approach is extremely costly and has few benefits over import restrictions other than not directly interfering with trade.

Non-support of the textile and apparel industries: This implies "sink or swim" for the Canadian manufacturers of textiles and apparel. Many of the existing companies would be unable to cope, leading to a drop in employment levels. This would potentially put an additional 500,000 people out of work. These workers would have to be retrained for other industries and where necessary and possible relocated (bearing in mind what has

[14] Canadian Apparel Manufacturers' Institute, *Apparel Industry Comments ..., op. cit.*, No. 3.

[15] *Ibid.*

already been said above). If even 50 per cent of these people can be otherwise gainfully employed, there would still be another 250,000 people requiring unemployment insurance and other benefits — in effect, a subsidy of textile and apparel employees, rather than the industry.

A recent report by the National Council on Economic Opportunity asserts that:

> ... a rise of 1 percent in unemployment ... is responsible for a rise of 3.4 percent in admissions to psychiatric institutions, of about 4 percent in suicides, of 2 percent in deaths from cardiovascular and renal diseases and cirrhosis of the liver, of 4 percent in state prison admissions, of 3.8 percent in homicides, 5.7 percent in robberies, 2.8 percent in larcenies, and 8.7 percent in narcotics arrests ....[16]

Given this scenario, tariffs on apparel and textiles could be abolished, allowing for a reduction in costs of apparel to Canadians, in part offsetting the expense of supporting the unemployed workers, if Canada is willing to incur the social costs resulting from such a move.

Should import policies be continued?

The existence of import controls on textiles and apparel results in higher prices on apparel for all Canadians. Abolishment of the controls would lead to political and social unrest. Surely it is worth something to Canadians to promote social and political harmony. What, then, is the solution? Will the needle trade ever be economically viable?

Import controls are meant to be a temporary measure — one which all too often turns into a permanent situation. Permanent import controls on textiles and apparel will not solve anything; they just camouflage the basic problems.

Clearly, though, the controls should not be terminated abruptly. Perhaps the optimal solution is to continue import restraints, in conjunction with a North American free trade zone, for long enough to give time to those sectors with potential for efficient, competitive operations to establish themselves, but with a definite enough withdrawal plan to avoid the influx of new capital into a dying sector.

Appendix: International Trade Agreements Affecting Canadian Textile and Apparel Import Policy

The GATT Arrangement Regarding International Trade in Textiles (MFA) came into force on January 1, 1974, providing international sanction under the GATT for the negotiation with "low-cost and state trading textile exporting countries of arrangements designed to minimize the disruptive effects of these countries' exports on the markets of importing countries." It also aimed at providing a climate for the orderly expansion of international trade in textiles.[17]

This instrument permits a nation to take a safeguard action of two general types against imports:

- It can negotiate bilateral restraint arrangements with exporting countries on a product-by-product basis after having established that the imports concerned have resulted in injury to the domestic industry.
- It can negotiate comprehensive bilateral arrangements with exporting countries, with a wide range of products included from yarn to garments, without the need to prove injury.

Under the first type, the restraint can be applied unilaterally if an exporter refuses to negotiate, while under the second, restraints are permitted only if *both* countries agree. Canada has followed the first type of course of arrangements. Other provisions of the MFA include such items as the minimum annual growth rate for restrained imports at 6 per cent or greater and rules for establishment of a base period from which restraint levels could be calculated.

Canada was not the only country signatory to the MFA to experience difficulty with it, and when the arrangement came up for renewal in 1977 major changes were proposed. At the conclusion of negotiations, however, a majority of the participants agreed to renew the MFA unchanged for a further four years (until December 31, 1981). This was accomplished by opening a Protocol to the 1973 Arrangement.

However, accompanying the Protocol were informal notes of the negotiating group. These are considered in fact almost as binding as the arrangement itself. In the notes the EEC is given the right to obtain in its bilateral negotiations with exporting countries "reasonable departures" from the terms of the MFA, particularly annual growth rate and base periods. The notes also underline the right of countries with small markets and high import penetrations to take import restraint action more severe than that permitted by the MFA. It is understood by many of the participants in the MFA discussions, however, that this applies to the Nordic countries alone. Many countries, including Canada, refused to sign the Protocol unless the same privileges of "reasonable departures" were available to them.

Canada, nevertheless, began negotiating comprehensive bilateral agreements with the major low-wage countries exporting textiles to our markets on the assumption that the "reasonable departures" clause does apply.[18]

Article VI of the GATT provides for compensating measures to cope with material injury caused by dumping or export-country subsidies. The remedy is restricted to a special duty not greater than the margin of dump for the products being dumped or the financial benefit received by the product by way of a bounty or a subsidy.[19]

Article XIX of the GATT provides for remedial action where exports are entering a country under fair competition but are causing serious injury to a Canadian producer. This article also provides that a country whose exports have been restricted may seek compensation by way of concessions in other product areas and that any action taken under this article be non-discriminatory, i.e., uniform for all countries.[20]

[16] John Hein, "Paging Adam Smith —," *Across the Board* (New York, The Conference Board, Inc., January 1981), p. 48.
[17] *Ibid.*, p. 102.
[18] Newall, *op. cit.*, pp. 57–59.
[19] *Ibid.*, p. 55.
[20] *Ibid.*, p. 56.

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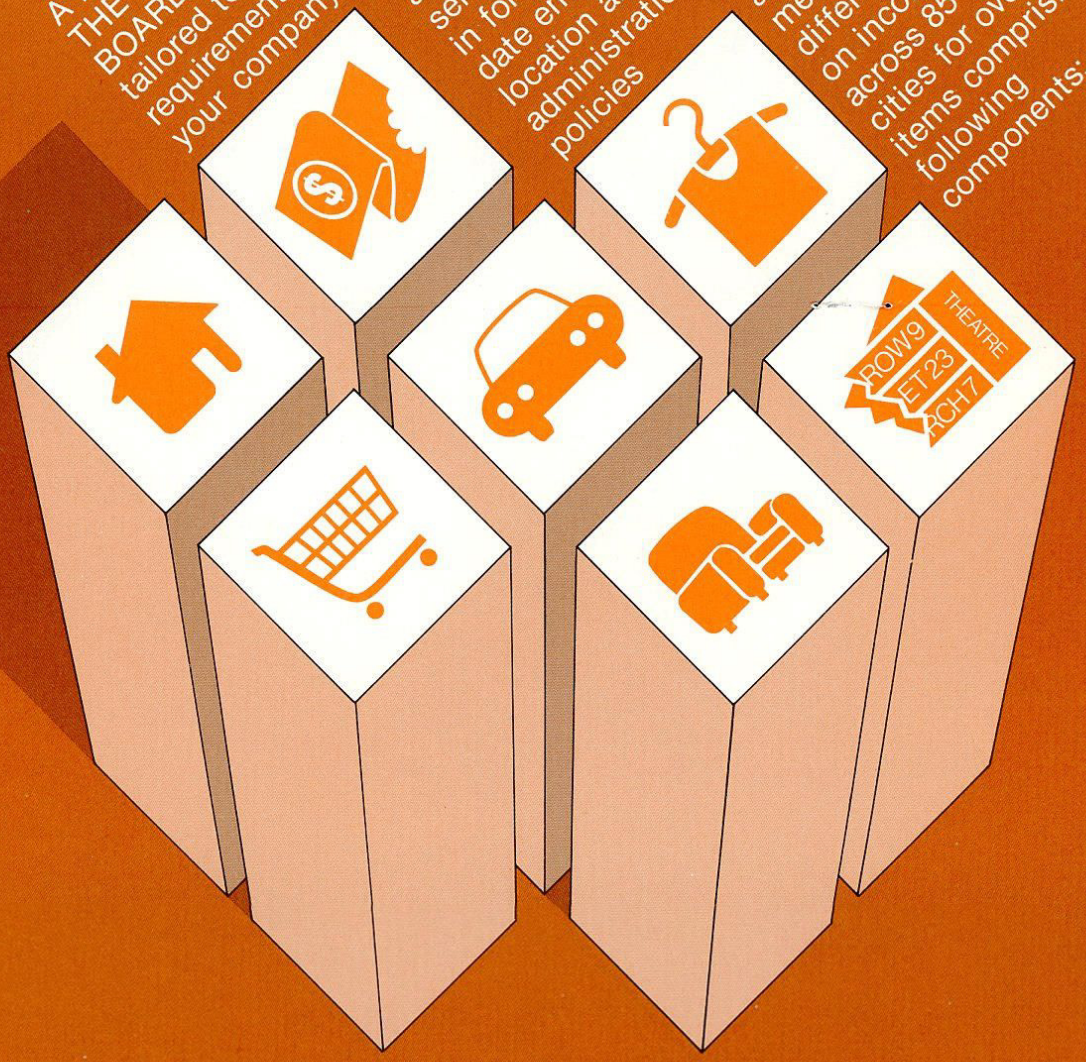

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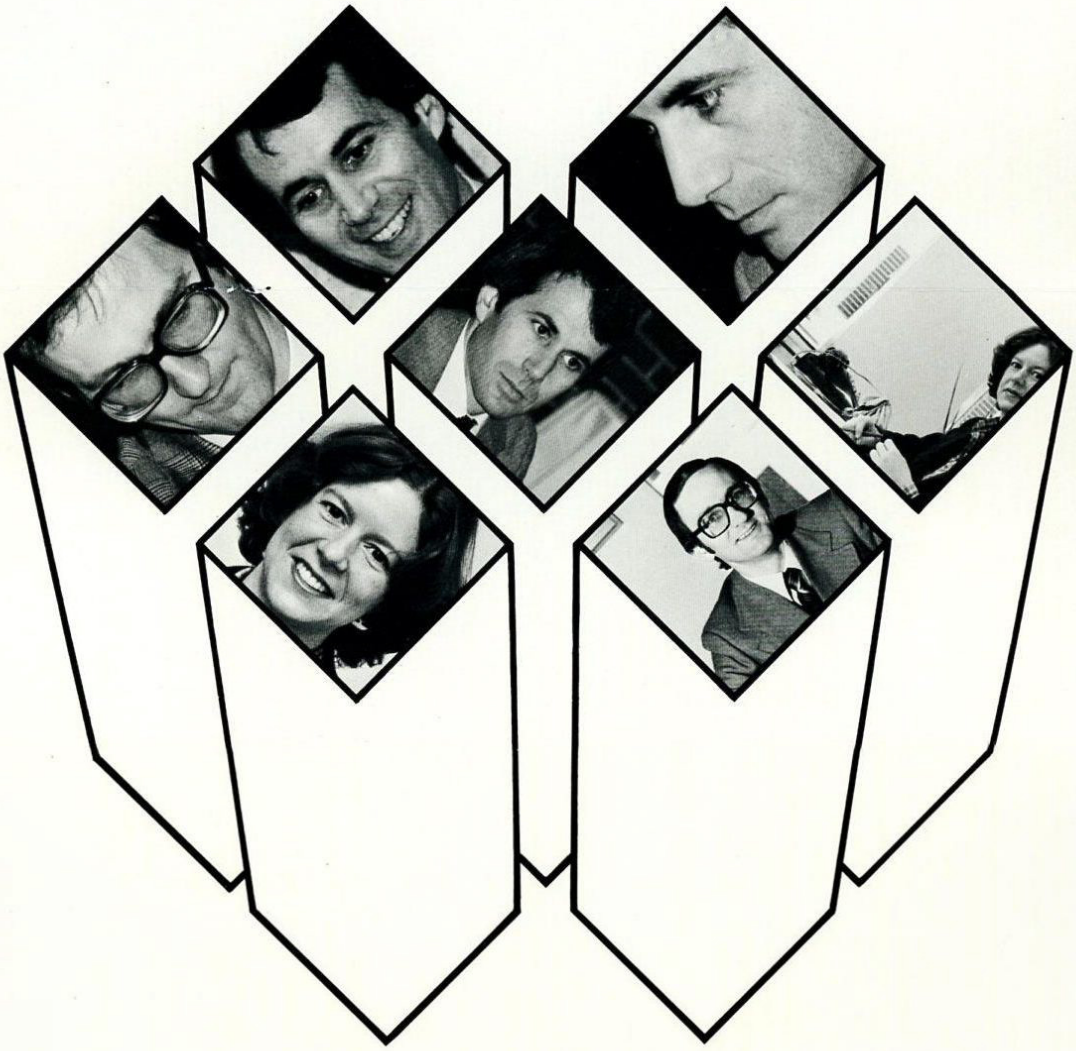

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